



OPEB Advisory Committee
Andover, Massachusetts
March 31, 2016



Options for Managing Other Post Employment Benefit Costs

OPEB Advisory Committee

This document is intended to provide a clear understanding of Andover's OPEB liabilities,
offer a plan to contain costs and reveal legislative impact.

Options for Managing OPEB Costs



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PREFACE

The Andover Other Post Employment Benefits (OPEB) Committee was appointed by the Andover Board of Selectmen on April 14, 2015.

At that time it was expected that the Committee would be able to come together and make a comprehensive report on the very complex and very substantial OPEB problem within a few short months. This expectation was optimistic to say the least.

At a time of conflict in our national history when our country continues to suffer from gridlock, and the 2016 Presidential election campaigns are filled with hostility and conflict, even our small Town of Andover is witnessing unprecedented acrimony and criticism concerning health insurance benefits for retired Town employees.

It is within this context the Committee came together with four (4) different viewpoints, four (4) different professional experiences and, even, four (4) different ages. The members of the Committee took an informal pledge that we would get to the finish line together – not with total agreement on every single point but, rather, united to make sure each viewpoint of each Committee member would be represented in this final report.

As part of this informal pledge, we realized we were joined by a powerful cord of admiration, respect and affection for our wonderful community and for all those who have made it so. In our effort to report on this highly complex issue which is confronting communities throughout Massachusetts and the United States, we strove to focus on creative approaches to potential solutions, rather than allow ourselves to be bogged down by the rancor which sadly seems to attach to political discourse in our society today.

We agreed there could be no political agendas or political interests involved in this work. Rather, to the contrary, we recognized early on that, since we have thirteen children and seventeen grandchildren among us, the importance of their futures and the futures of all Andover children had to be the principal impetus for the conduct of our Committee and the completeness of this report. Simply put, each of us wants all Andover children to enjoy the same privileges and opportunities we have had as Andover citizens.

Left unchecked, the OPEB phenomenon would defeat this desire for economic security for our community's coming generations. If not appropriately addressed, the financial burdens of OPEB will change Andover forever in very dramatic and detrimental ways. No consequence of an unchecked OPEB crisis would be worse than denying future generations all of the benefits of our great town.

Andover's citizens must come together to resolve the OPEB problem in a manner which does not jeopardize the very services which have made this town great.

In order to accomplish this, we all must first appreciate the size and scope of the OPEB problem. We hope our report states the problem clearly and, just as clearly, sets out how Andover citizens must solve it.

As it turned out, the Committee held twenty five (25) public meetings and spent countless hours outside of the regularly scheduled meetings completing research and engaging in dialogues. Simply stated, the volunteer members of this Committee have spent hundreds of hours in the compilation of this report. At all times, we have strived to be open, fair and respectful of all opinions and perspectives.

A few of our citizens have criticized the Committee for taking so long in its deliberations. We assume these same folks may be disappointed to read the provisions of Recommendation Number 14 in our report which calls for the establishment of a permanent OPEB Committee as a part of our Town Government because the study of OPEB should never cease until the liability disappears. The permanent committee shall be charged with further research, monitoring the issue closely and advising our Boards of Selectmen and Town Managers well into the future. The permanent committee must join with other communities to seek reform at the state level, where ultimately the problem must and will be solved.

Sadly, future town governments and taxpayers will necessarily pay for the decades during which the OPEB problem was allowed to worsen. Ultimately, and make no mistake about this, the Commonwealth of Massachusetts through its Governor and its Legislature must correct the ancient and arcane body of law which allowed its municipalities to get into the mess in which they now find themselves. It is clear that only a sweeping change in Massachusetts law will meaningfully address the OPEB crisis.

Although Andover has strived to make cash payments to mitigate the OPEB unfunded liability, such funding remains insufficient to fund the OPEB debt. Beyond greater funding, a permanent solution to this problem rests in the municipalities and the state engaging in far greater and far more creative solutions.

It is very clear to this Committee that integral to the solution of the OPEB problem is ensuring that all stakeholders work earnestly, cooperatively and collaboratively to guarantee the future financial strength of Andover and the continued delivery of excellent services to its citizens. Anything short of this will jeopardize the economic and social future of generations to come.

While so many people have contributed to the Committee's efforts, we specifically would like to thank the following individuals who appeared before the Committee and shared their advice and wisdom. They are in alphabetical order.

Steve Bucuzzo, former Assistant Town Manager
Attorney Phil Collins, Labor Counsel
Andrew Flanagan, Town Manager
John Foskett, Health Insurance Legal Advisor
Candace Hall, Director of Human Resources
Barbara L'Italien, State Senator
Ken Lombardi, Town Benefit/Healthcare Consultant
Jim Lyons, State Representative
Katie McCue, Legislative Analyst for the
Massachusetts Municipal Association

Frank Moran, State Representative
Larry Murphy, Town Clerk
Mary O'Donoghue, Selectmen Chair
Jim Powers, Audit/Accounting Consultant
"John Smith", Governor's Office
"Buzz" Stapczynski, former Town Manager
Tom Urbelis, Town Counsel
Liz Valerio, Labor Counsel

We want to thank our Town's Budget and Finance Director, Donna Walsh, for the generosity of her time, expert assistance and spirit throughout this process. We also wish to express our sincere gratitude to Christine Barraford, Executive Secretary for the Town's Finance Department, who was steadfast and patient in her professional support of the Committee's efforts.

Lastly, we want to dedicate all of our efforts, all of our work and this report to the men and women who work for the Town of Andover – past, present and future. There are many great privileges we enjoy in this community – none greater than to be the beneficiaries of the skills, talent and passion of the men and women who have provided and still do provide dedicated service to this community and all of its residents.

Respectfully submitted,

Michael W. Morris, Sr., ESQ., Chair

Mark S. Baldwin, Vice-Chair

Steven G. Caron, CPA

Thomas P. Hartwell, CPA

March 31, 2016
Andover, Massachusetts

OPEB ADVISORY COMMITTEE
Report of Recommendations
March 31, 2016

Introduction

Massachusetts Other Post Employment Benefits (“OPEB”) liabilities have grown to a critical level. Andover currently faces a \$184 Million OPEB liability, while Massachusetts cities and towns have collectively incurred a \$46 billion liability. If nothing is done, Andover’s OPEB liabilities will grow to \$652 million in 30 years. Although a great deal of effort has been placed on reducing the unfunded pension liabilities, the growing OPEB liabilities have received far less attention. With rising health costs and changing accounting regulations, OPEB liabilities will continue to escalate. For Andover, managing the unfunded OPEB liabilities will be critical to ensuring a quality workforce, maintaining exceptional services and minimizing tax burdens.

The OPEB Advisory Committee was established to meet the following goals as indicated in the OPEB Advisory Committee **Mission Statement**:

1. Develop a clear understanding of the town’s liabilities for retirees.
2. Create a plan for containing current and long-term OPEB costs.
3. Coordinate with Legislators on effective cost containment measures.

Goal #1: Develop a Clear Understanding of the Town’s Liability - (What is OPEB?)

Determining Andover’s liability begins with understanding OPEB and how the OPEB liability is calculated. **Other Post Employment Benefits** “are benefits other than pensions that U.S. state and local governments provide to their retired employees.” (Source: *Government Accounting Standards Board*) These benefits may include healthcare benefits, prescription drugs, disability insurance, dental and others. Because the OPEB liability is based on benefits that have not yet been received, calculating the current liability can be challenging.

Calculating the value of the OPEB liability for state and local governments is done through actuarial assumptions developed within the guidelines of GASB Standards. **Actuarial Assumptions** “are projections of future events that affect the cost and funding.” (Source: *NASRA- National Association of State Retirement Administrators*) In essence, actuaries are forecasting the cost to Andover of future retirees and estimating what the funds set aside to pay for these liabilities will be worth.

Actuaries use economic and demographic data to create the forecasts and to determine the current value of OPEB liabilities. Economic data would include areas such as the forecasted rate of return for assets set aside for OPEB and inflation. Demographic data may include the average retirement age and the life expectancy for potential beneficiaries. Because these factors are subjective, actuarial values

may vary widely. Yet, there are standards established by GASB that are designed to bring a higher level of certainty and consistency to the forecasting process.

The Government Accounting Standards Board (**GASB**) establishes the accounting standards used by state and local governments in calculating OPEB liabilities. Since 2004, GASB has been introducing standards to improve the accuracy of OPEB reporting. Most recently, GASB introduced two new standards designed to “enhance the decision-usefulness of the financial reports..., their value for assessing accountability, and their transparency...” (Source: GASB) GASB Statement No. 74 becomes effective June 15, 2016 and requires the reporting of the net OPEB liability (*total OPEB liability – plan’s fiduciary position.*) GASB Statement No. 75 becomes effective June 15, 2017 (for FY 6/30/18 reporting) and mandates the OPEB liability be placed on the Town’s balance sheet, and that a variety of assumptions used to calculate the OPEB liability be published in the financial statement footnotes. The statement also mandates the assumptions used to determine the OPEB liability, such as those used to calculate the discount rate, meet specific criteria. The GASB standards are designed to establish more accurate financial reporting and allow interested parties to make sound decisions.

It is in all of the stakeholders’ best interests to use a realistic, conservative approach in calculating OPEB liabilities. Underestimating the liability increases the chance that funding for future benefits is inadequate and that the unfunded liability continues to grow at an unsustainable rate. Overestimating the liability can lead to unnecessary cost cuts and non-competitive health benefits and can reduce funding for other critical expenditures. Getting these estimates right helps to ensure that health benefits offered by Andover are competitive, sustainable and properly funded.

The Committee shares the belief that positive change begins with a realistic and conservative approach to the actuarial values. Andover has always been a fiscally conservative town and we see great benefits in continuing this fiscal policy. Maintaining a conservative approach to the actuarial forecasts increases the likelihood that Andover will be able to meet its commitments to employees and residents while decreasing its debt for the next generation.

To maintain a clear understanding of the town’s liabilities for retirees, well-founded actuarial reports are essential. To ensure the accuracy and timeliness of actuarial reports, the Committee offers the following strategies:

1. **Ensure the actuarial analysis is performed every two years as required.** The Town originally planned to perform its next actuarial report for June 30, 2016, which would be three years from the last report. The Town agreed to two years and the June 30, 2015 actuarial report was published on March 15, 2016. Using current information is essential in evaluating performance and allows adjustments to be made to changing conditions.

2. **Evaluate the assumptions used, particularly regarding the discount rate, and insure they are conservative and achievable.** Past performance should be evaluated and changes made in investment strategy, methods and assumptions if targets are not reached. The Government Finance Officers Association attempts to increase accountability by suggesting “an independent actuary perform a comprehensive actuarial audit of the actuarial valuations at least once every five to eight years.”
3. **Prepare for the GASB 75 standards by calculating the impact on the 2016 financial statements and communicating the affects through footnotes and/or other disclosures in the Town’s Comprehensive Annual Financial Report.** Although implementation is required for fiscal years beginning after June 15, 2017, GASB states that “early application is encouraged.” (*GASB- Summary of Statement No. 75*) GASB 75 will require the Town to record unfunded OPEB liabilities on its balance sheet and potentially use a lower discount rate in valuing its OPEB liabilities. A portion of the OPEB unfunded liabilities is already on the Town’s balance sheet. When the remainder is put on the balance sheet, it is likely that the Town will have a negative net worth. Because this standard improves the accuracy of the OPEB liability calculation, understanding its impacts prior to the deadline will aid in OPEB decision-making and help the town prepare for the upcoming change.
4. **Communicate the actuary’s results to all affected stakeholders.** Actuarial results help reveal the true costs of post-employment benefits to decision-makers and taxpayers. They also indicate the level of sustainability, which provides comfort and confidence to employees. It is imperative to determine the most effective methods for communicating this information and its impact on OPEB to all stakeholders.

***The Committee worked with the Town and the actuary on the June 30, 2015 actuarial report and believes the rates and assumptions used are realistic and conservative. We would like to thank the Town for working with the Committee to achieve significant progress in the implementation of the above recommendations.**

Goal #2: Create a Plan for Containing Current and Long-Term OPEB Costs

Based on our research of the current liability, this Committee agrees that a plan for containing current and long-term OPEB costs is vital. Without change, the unfunded OPEB liability (*net liability*) will continue to increase and have a negative impact on Andover. The potential impacts include:

- A. Decline in services paid for by tax dollars and a corresponding increase in fee based services that must be paid for by users, e.g., school bus transportation, athletic fees, kindergarten tuition, etc.
- B. Inability to hire needed personnel.
- C. Significant increases in tax rates.
- D. Erosion of the Town's Triple A bond rating.
- E. Weakening in Andover's ability to compete for new employees.

This Committee is unanimous in its attempt to provide balanced options that contain OPEB costs while maintaining Andover's ability to compete for the highest quality employees. All of the following recommendations are designed to ensure competitive and affordable OPEB benefits, maximize long-term sustainability and provide a fair burden to taxpayers. The recommendations are organized into the following categories:

- **Economic Recommendations**
- **Strategic Recommendations**

ECONOMIC RECOMMENDATIONS

Regardless of the actuarial assumptions used, it is clear the Town currently has a significant unfunded OPEB liability that threatens future benefits as well as town services. There are three main contributors to the growing OPEB liability:

1. A significant rise in healthcare costs. The US News Healthcare Consumer Price Index reveals an increase in consumer price levels by over 70% between 2000 and 2013.
2. Inadequate funding by the Town. As the unfunded liability became apparent, extraordinary measures to reduce costs or establish reserves were not taken.
3. Poor investment earnings. Using the S&P 500 as a general indicator, the long-term (50+ years) inflation-adjusted annualized rate of return has been between 6% and 7%. Between January 1, 2000 and December 31, 2015 the inflation adjusted annualized rate of return has been 1.83%. The market's poor performance over the past decade not only impacts the investments set aside for OPEB, it negatively impacts future projections.

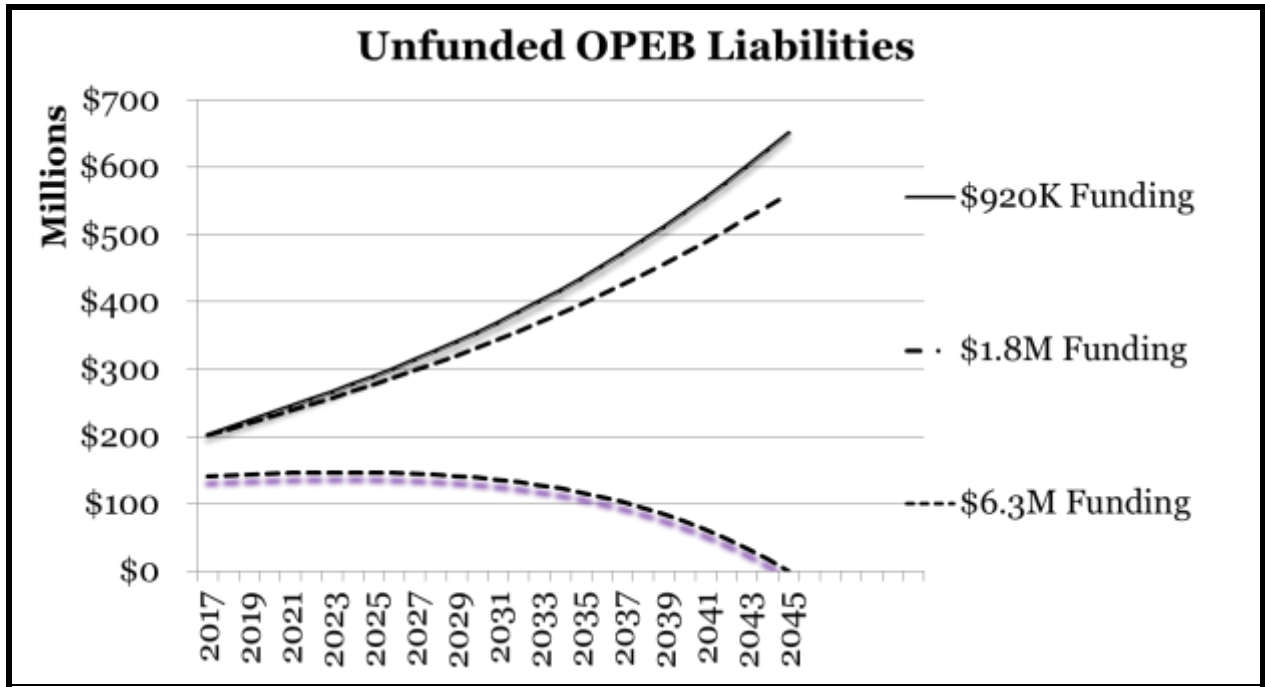
The combination of rising healthcare costs, limited reserves and declining returns have resulted in unsustainable healthcare benefits. The following Economic Recommendations are designed to contain OPEB costs and mitigate these trends.

Recommendation #1

Develop a funding policy with the intention of fully funding OPEB.

All of the recommendations made by this Committee and reform changes proposed at the state level will not pay off OPEB unfunded liabilities without increased funding by the Town. The June 30, 2015 actuarial report projects the Town’s unfunded liabilities to be \$652 million in 30 years before any reforms. The actuary provided a schedule showing the Town needing to contribute \$6.3 million annually (this amount increasing 3.75% annually) in order to pay off OPEB liability in 30 years. The Town’s current plan for FY2017 is to contribute 0.50% of revenues which would be approximately \$920,000. This amount is down from the \$2 million the Town contributed in FY2016.

The Town needs to increase its FY2017 OPEB funding. Finding the money is easier said than done. A tight operating budget, large infrastructure needs and other daunting fiscal challenges will make this difficult. This difficulty, however, will pale in comparison with the wall of debt future taxpayers face if the Town does not act. Sadly, future generations will be paying for the benefits we are receiving today. We recommend the Town increase its FY2017 funding to at least \$1.8 million and develop a plan to fully fund OPEB within 35 to 40 years.



Recommendation #2

Systematically increase the retirees’ premium contribution rate to 50%.

As healthcare costs continue to rise at a greater rate than the rest of the economy, sharing a greater percentage of the burden has become essential in establishing sustainability. Sharing a greater percentage of the cost has become common among private and public entities. For example, in 2002 “less than half of private-sector health insurance plans had a deductible.” By 2013, more than 80 % had a deductible, and the amount paid by consumers was skyrocketing.” (U.S. News & World Report, May 7, 2015) In order to properly sustain benefits and manage costs, recipients must bear a greater percentage of the healthcare costs.

In Massachusetts, changes to retiree contribution rates can occur without engaging in collective bargaining. This allows changes in contribution rates for retirees to be implemented quickly and easily. We recommend the Town increase retiree contribution rates to 50% over a three to seven-year period. This recommendation, when fully implemented, will reduce the Town’s OPEB liability by approximately \$53 million (*Provided by the Actuary on March 24th*) The Board of Selectmen has the authority to implement this recommendation.

Impact On Current Retirees

Plan Description	Retiree Current Contribution	Town Current Contribution	% of Town Contribution	% of Retiree Contribution	# of Retirees Impacted	Retiree Future Contribution					
						Year 1		Year 2		Year 3	
Medicare Plans:											
Medex2	\$1,358	\$2,522	65%	35%	432	40%	\$1,684	45%	\$2,046	50%	\$2,444
Managed Blue											
Senior	\$521	\$3,281	86%	14%	325	19%	\$784	24%	\$1,069	29%	\$1,389
Non-Medicare:											
Plans											
Blue Care Elect											
Family	\$8,747	\$16,244	65%	35%	22	40%	\$10,746	45%	\$12,936	50%	\$15,307
Blue Care Elect											
Individual	\$3,264	\$6,061	65%	35%	37	40%	\$4,010	45%	\$4,827	50%	\$5,712
Network Blue											
Family	\$4,622	\$15,387	77%	23%	56	28%	\$6,023	33%	\$7,595	38%	\$9,314
Network Blue											
Individual	\$1,403	\$6,020	81%	19%	97	24%	\$1,915	29%	\$2,476	34%	\$3,092

1. Medicare premiums are assumed to rise by 8.5% year-1, 8% year-2 and 7.5% year-3 as provided by the Actuary.
2. Non-Medicare premiums are assumed to rise by 7.50% year-1, 7% year-2 and 6.5% year-3.
3. Retirees Future Contribution for Years 1, 2 and 3 are calculated by increasing the retiree's contribution by 5% each year.
4. Retiree Current Contributions for Seniors under the Medicare Plan includes contributions to Medicare Part B only and does not include other supplemental insurance that may be paid directly by retirees.

A. The “Spanos Bill”

This alternative recommendation stems from public discussion during the open OPEB Committee meetings. During one of the meetings, Joe Spanos, an Andover High School Teacher, voiced a desire for current employees to voluntarily contribute a greater share in order to maintain existing contributions for retirees. To the degree where the same cost reduction can be reached, we believe flexibility should be offered to the recipients. Although this recommendation is complex, leadership could be exemplified by forging a deal with union leaders and retirees resulting in a better deal for all stakeholders. Therefore, we recommend a public discussion take place with union leaders to discuss their desire for sharing retiree costs.

Recommendation #3

Systematically move current employees’ premium contribution rate to 50% through collective bargaining.

The Committee recommends, through collective bargaining, the process of systematically reducing the Town's health insurance contribution to the statutory minimum of 50% for all active employees. The Town should also request, as a starting point, all future employees hired be required to immediately pay 50% of their healthcare cost. Subject to applicable law, this will require that the Town is entirely consistent in its bargaining positions with regard to the Town's level of premium contribution. The rationale is similar to that stated in recommendation #2 and recognizes that rising costs have forced public and private entities throughout Massachusetts to enact similar changes. Education on the unsustainability to pay future OPEB benefits if reforms are not implemented will be critical in this collective bargaining process.

Recommendation #4

Increase eligibility standards for participation in the Town’s Retirement Plan from 20 hours to 30 hours for new employees.

The easiest long-term reform for retirement benefits is to reduce them for new employees. Increasing the hours for retirement eligibility would also change the eligibility for OPEB. In order to receive OPEB benefits, you must participate in the Town’s Retirement Plan. This will not reduce the current OPEB unfunded liability but will save money for the Town in years to come. Using the number of part-time employees currently working 20-29 hours, this change would potentially affect 51 employees when they are replaced. This will have no impact on current employees. Forty-seven is the average age for current Town employees which indicates the majority of these 51 employees would be retiring over the next 10 to 15 years. If this eligibility change were to be applied to the 51 employees active today, the Town’s

OPEB liabilities would be reduced by approx. \$4.6 million (Provided by the Actuary on March 24). This change would require approval by the Andover Retirement Board as they have full authority under Massachusetts chapter 32 to determine eligibility of part-time employees.

Although this recommendation has a potential negative impact on future hires, public perception reflects a growing need for change. There is a nationwide move to increase hours for eligibility. Part of the acceptance stems from the qualifications under The Affordable Care Act, which uses a 30-hour threshold.

The Committee reviewed two alternative recommendations and considerations that would replace the above Recommendation:

- A. **Increase eligibility requirements from 20-hours to full-time for all new employees.** One option would be to further increase the eligibility to full-time, which would range from 36.25, 36.5 or 40 hours depending on the category of employee. This would add an additional 57 positions, bringing the total to 108 future new employees who would not be eligible for OPEB when the current employees leave their position. Although this would further cut long-term costs, the majority of the committee felt that this increase would negatively impact Andover's ability to compete for qualified candidates. The majority also favored an incremental increase in eligibility, with the option of readdressing a second increase in future years.

- B. **Redefine the standard to qualify to a set number of service hours.** A second alternative option would be to redefine the standard to qualify for retirement benefits to a set number of service hours that applies to all employees. Changing the standards to a fixed number of hours regardless of the years of service would provide greater flexibility to employees with changing family needs. This provides the unique advantage of incentivizing employees with specialized skillsets valuable to the Town. Savings under this plan would be generated by effectively requiring more years of service from certain employees prior to qualifying for benefits. This option was generally accepted by the committee, yet the majority felt additional research was needed to ensure the predetermined number of hours would result in a net savings. With proper additional research, the majority felt this would be a viable recommendation.

Recommendation #5

Eliminate the ability to “buy back time” or receive pro-rated credits for hours worked below the eligibility level.

This option would ensure only employees meeting the specific eligibility requirements receive lifetime healthcare benefits upon retirement. It would also provide the benefit of hiring additional part-time employees knowing specifically whether they will qualify for future healthcare benefits. There is currently a case pending (*Stoneham Ret. Board v. Crab*) which will provide direction on whether or not this option can be implemented. A cost savings cannot be quantified, but Retirement Board records indicate 8 employees were able to “buy back” time last year. This recommendation requires approval by the Retirement Board.

Recommendation #6

Limit cost of living increases (COLA) for retirees until the Retirement Plan is fully funded.

By Statute, the Andover Retirement Board can give COLA increases of up to 3% on the first \$12,000 of retirement income for town employees and on the first \$13,000 for teachers. Limiting COLA increases on pensions is necessary given the Town’s serious financial condition and to ensure basic retiree benefits are protected. The Committee recommends annual COLA increases limited to the annual Social Security increase, up to a maximum of 3%. Social Security announced a 0% increase for 2016. The Retirement plan’s unfunded liability would be reduced by approximately \$2.8 million and future payments of \$9.6 million would be reduced if 0% COLA increase was approved by the Retirement Board for 2016 (provided by the actuary based on 2014 data). Once the pension plan is fully funded, the Town will be able to increase its funding of OPEB with monies previously going towards pensions.

The Retirement Board has sole discretion of approving annual COLAs. The town should actively encourage and work with the Retirement Board to consider this recommendation.

Recommendation #7

Consider reimbursement from other towns when an employee retires from the Town and had previous employment with one or more other government units.

Under Massachusetts Chapter 32B Section 9A1/2, where an employee retires from the Town and had previous employment with one or more other government units, the Town may seek reimbursement for OPEB costs from those other units. Three rules apply:

- Reimbursement is limited to premium contributions by the Town;
- Reimbursement is based on the percentage of the employee's creditable service under Chapter 32 rendered to the other unit(s); and
- The other unit(s) are charged based on the lower of (a) each unit's own contribution rate or (b) contribution rate of the first employing unit.

Town management represented the net impact of charging other towns and being charged would result in only a modest savings to the Town. Charging other towns could set a precedent resulting in other towns seeking the same reimbursement. There are no state mandates requiring payment. The Committee recommends the Town prepare a documented analysis to determine the actual net savings/cost if they started charging other towns. There is legislation pending which may prohibit the Town from charging other towns.

Recommendation #8

Evaluate buying out employees' vested benefits in OPEB.

Implementing this recommendation would require buying out vested employees for the fair actuarial value of their accrued benefits on a voluntary exchange basis. The Town would fund this program by issuing bonds. One city in California, which received national attention, sold a bond issue at 4.5% and used the money to fund a voluntary exchange program in which current employees could cash out the actuarial value of their previously earned OPEB benefits and receive an employee health savings account plus a package of cash and deferred compensation. 58% of the eligible employees made the election, which saved the city millions of dollars. The city also set up a defined contribution OPEB plan for new employees. The State would have to approve allowing us to do a similar program as the Town currently does not have the power to do it.

Recommendation #9

Consider transitioning to defined contribution style plans.

A defined contribution plan identifies the financial contribution that will be made to employee healthcare rather than defining the health plan that will be provided. This type of plan would be beneficial in establishing budgets for the Town and would provide greater flexibility for the employees. Having the consumer (employee) making the healthcare decisions also leads to lower healthcare costs as greater effort is placed on cost savings and value. These style plans could also be complimented by deferred contribution plans offered to employees not qualifying for full participation. Additional research should be completed to identify what types of defined contribution plans are available to the Town. Also, this change would require state approval.

The logic in offering such a program is that using a defined benefit (pension-like) financial model to fund an undefined and escalating benefit is unsound. The Town would get out of the business of guaranteeing retiree medical benefits it can't afford. Unlike pensions, which can be reasonably predicted by their payout formulas, future retiree medical inflation rates are completely unknown. Retiree medical costs are typically unlimited and have run well ahead of inflation, wages and tax revenues. No one can reasonably predict what the costs of healthcare premiums will be in 30 years. The Committee recommends further study on this approach.

Recommendation #10

Require that an employee retire from the Town or have 25 years of vested service in order to qualify for OPEB.

The Committee recommends the Board of Selectmen issue a regulation conditioning eligibility for retiree health insurance on the employee having 25 years of vested service or retiring from the Town. The legality of issuing such a regulation would need to be further researched by the Town's attorney. The financial benefit in issuing such a regulation is difficult to quantify as it is unclear if it can be applied to current inactive employees or if it can only apply prospectively to future employees leaving the town and not retiring.

STRATEGIC RECOMMENDATIONS

The Committee's Strategic Recommendations are designed to insure the long-term success of reducing and eliminating future increases in the unfunded OPEB liability. OPEB is a complex issue that impacts workers and town residents, and managing it effectively will have a positive impact on the Town. Managing the OPEB crisis will require a coordinated effort and a long-term commitment. It will also require communication and reporting that is accurate and understandable for all stakeholders. The Strategic Recommendations are designed to meet these specific long-term goals.

Recommendation #11

Work with the Retirement Board to consider eligibility reforms. Authorize the Town Manager to review the composition of the Retirement Board to ensure it is representative of all of the Town's stakeholders and to authorize the Town Manager to take all necessary action to ensure that it is, in fact, representative. Review the composition of the Retirement Board to insure that it possesses the necessary skill sets consistent with its mission.

The Board of Selectmen should work with the Retirement Board to institute eligibility reforms recommended in this report.

The Andover Retirement Board is a governmental body which has as its primary responsibility the management of pension benefits of both current Town employees and retirees. Its existence and powers are authorized by state law. It operates almost independently from Town government insofar as its primary responsibility is to the Town's employees and retirees. Please note that the Town's teachers' pensions are managed by the state.

The depth and breadth of the Board's power is somewhat unknown to Andover's taxpayers. For example, the Board has great discretion in setting the eligibility standards for participation in Andover's Retirement Plan. What is almost totally unknown by local taxpayers is that all those eligible for a Town pension are also automatically eligible for health insurance benefits ("OPEB") upon retirement. Additionally, the Town's teachers are included in the Town's OPEB Program although their pensions are administered by the state. Therefore, decisions regarding pension eligibility have very significant consequences to the Town's financial wellbeing. For example, in one scenario, if a person works 20 hours a week for 10 years, he/she can retire at 55 and a) is eligible for a pension, and b) is eligible along with his/her spouse for lifetime OPEB benefits .

The Retirement Board has five members who are chosen in the following manner:

- The first member is the City Auditor or Town Accountant or other officer having similar powers and duties and is a member ex-officio.
- A second member is appointed by the Board of Selectmen.
- The third and fourth members are elected by the Town's active and retired members of the pension system.
- The fifth member cannot be an employee, a retiree, or official of the Town, and is chosen by the other four members.

A key recommendation by the Committee is the need for reform in determining eligibility for retirement and, therefore, OPEB. At this writing, the Retirement Board has not addressed reform changes that will positively affect OPEB.

The Retirement Plan's reported \$107 million unfunded liability will likely increase significantly when the January 1, 2016 actuarial report is prepared. The fully funded pension date of 2032 will likely be extended as new actuarial data becomes available. This will only add to the Town's problems in trying to deal with its ability to pay future retiree benefits.

There are a handful of Massachusetts communities that will fully fund their pension liability within the next five to ten years. After these towns fully fund their pension liability, they will be able to pivot and start using the funds previously used for reducing pension liability to be used to reduce OPEB liability, a much bigger obligation. Our Town will not be able to address its OPEB liability using these funds until 2032 at the very earliest and probably not then. Because of this fact our OPEB liability will be allowed to grow for at least 16 more years, but most probably longer, all the while undiminished by our inability to use the previously dedicated funds used to retire Town's pension liability.

The composition of the Retirement Board is mandated by state law, a law which is unlikely to be changed in the foreseeable future. Nevertheless, the Committee recommends to the Board of Selectmen that it review the makeup of the Board. Further, the Committee recommends a joint study group be formed between and among the Retirement Board, Town's employees/retirees and the Board of Selectmen to develop a matrix of skills through which they, together, can identify the most important capabilities which Board members should possess. In that way they would be able to contribute to the successful performance of the Board and make appropriate impacts on retirement eligibility standards prospectively which, in turn, will have beneficial impacts on both of Andover's huge and growing unfunded liabilities. Investment management and actuarial experience are two examples of skills the present Board lacks. Present Board members should be evaluated against this matrix.

Recommendation #12

Implement a Pre-funding plan for new hires, where expenses are accounted for as they are earned.

Financing benefits as they are earned for new hires eligible for OPEB will help to slow the growth in OPEB unfunded liabilities. Using this method, actuaries would determine an average annual per employee cost for OPEB. This expense would be accrued each year, with funds set aside in the OPEB trust fund. Under this plan, the OPEB liability would be funded as it is earned, linking the expense directly to employment. This provides clear advantages in establishing sustainable benefits and provides more accurate costs during the hiring process.

Recommendation #13

Implement a unified approach to collective bargaining.

The Board of Selectmen should adopt a resolution or, in the alternative, a town meeting article should be adopted, to create a mandatory conference between those consultants and administrators charged with collective bargaining on behalf of the Town, said conference to be consistent with applicable law. The Town Manager should be charged with chairing this conference and the objective of said conference is to ensure all of our negotiators are conveying a unified message with regard to OPEB and all other appropriate matters subject to collective bargaining.

To date, significant progress has been made in the implementation of this recommendation. In the spirit of this recommendation, after some discussion, the Town Manager took a giant step in implementing this recommendation by retaining the services of a single labor counsel for purposes of collective bargaining.

Recommendation #14

Establish a permanent OPEB Committee.

Members should have investment management, accounting, actuarial and risk management skills. Committee responsibilities will include, but not be limited to, developing an investment policy and asset allocation strategy, review and approval of rates/assumptions used in actuarial reports and continually looking for improvements in the OPEB program.

The Andover Retirement Board is in the process of hiring an investment consultant to help with the development of its investment policies and asset allocation strategies. The consultant will also advise the Retirement Board on what investments they should make. The OPEB trust assets should have similar investment policies and asset allocation strategies as its investments have the same long term horizon.

The Permanent OPEB Committee should review the policies and results coming from the Retirement Board's investment consultant.

This Committee could also serve a very useful purpose in helping the Town in its communication to employees and retirees about the progress of the plan, current benefit levels, and any other factors that could affect the plan's ability to pay sustaining benefits in the future.

Recommendation #15

Establish control policies regarding OPEB participation and reporting.

Processes for controlling participation in the pension/OPEB system and data provided to the actuary needs to be developed. Well designed and maintained internal controls will provide reasonable assurance OPEB benefits are provided only to eligible employees/retirees. OPEB unfunded liabilities will be the largest liability on the Town's balance sheet with the adoption of GASB 75. It is important that the Town has controls suitably designed and implemented to achieve proper participation in the Town's Retirement and OPEB Plans and reliability of data reported to the actuary. We recommend the following:

- Form a project team to allocate responsibilities, assess resources, decide on approach and establish timing.
- Collect data on the current control environment by assessing areas of risk and reviewing existing practices.
- Prepare an inventory of existing and available documentation and controls.
- Evaluate internal controls and prepare a gap analysis to identify areas of concern requiring further follow up.
- Remediate the identified gaps and validate that these areas have been fully addressed.

Recommendation #16

Adopt a comprehensive compensation model that reflects the true employee/candidate cost.

The Town should implement a simplified employee compensation model that factors in the value of its benefit programs and the non-economic lifestyle features enjoyed by its employees. As a general matter, the total compensation for a set of skills should be offered at a similar compensation rate to what the same set of skills command in the private markets.

Recommendation #17

Create a Compensation Advisory Committee.

Prior to implementing any material change to the elements of compensation that it provides to its employees and retirees, the Town should first create a Compensation Advisory Committee composed of Andover taxpayers. It would be charged with i) reviewing the Town's overall compensation system and its current application to the various job categories, ii) offering proposed improvements believed to simplify and insure the program is both competitive and supported by taxpayers, and iii) monitoring on a continuing basis appropriate overall compensation ranges for the job categories required by the Town as a service to the Board of Selectmen and the School Committee charged with negotiating with employee unions.

Recommendation #18

Implement a meaningful Wellness Program.

The Town should aggressively implement a meaningful Wellness Program that applies to its current employees and retirees, whose implementation promises an authentic reduction in the growth of medical costs that would measurably deliver an attractive return on equity. Employees that opt not to comply with the program requirements will choose to forego economic incentives available to those who participate.

Recommendation #19

Implement Citizen's Dashboard concept.

The town management should implement the Citizens' Dashboard concept long advocated by the Town's Audit Committee to provide citizens with timely and readily-understandable information on critical measures of the cost and performance of the Town's operations. OPEB data should be incorporated into the Citizens' Dashboard, which would allow the taxpayers to better monitor effectiveness and efficiency with which their tax dollars are being used on their behalf.

***Recommendation #20**

Ensure cost savings are dedicated to OPEB.

This Recommendation envelops all of the Committee's previous recommendations. It is essential that the cost savings of implementing these recommendations are actually applied to OPEB and not used to fund other town needs. In order to maintain employee trust and achieve an OPEB liability reduction, savings must be used to fund OPEB costs. Most of the cost savings automatically impact OPEB only, serving to directly reduce the OPEB liability. However, to the degree that savings can be used to enhance other areas of the budget, accountability needs to be present.

*The above recommendation was developed in support of public feedback offered on March 24, 2016.

Goal #3: Coordinate With Legislators on effective cost containment measures.

The OPEB crisis is not unique to Andover. Former Governor Deval Patrick recognized the serious problems the State and municipalities were facing with the growing OPEB liabilities and appointed a Special Commission to study retiree healthcare and other non-pension benefits. This Commission issued its report on January 11, 2013 noting the unfunded liability for State and local government amounted to approximately \$46 billion, a liability larger than the unfunded pension liabilities in the Commonwealth. The report contained a list of recommendations for the Governor and Legislature to consider.

The Governor filed House Bill 59 on February 12, 2013 containing recommendations from the Commission's report to reform the structure of retiree healthcare provided by State and local governments to make it more equitable and sustainable. This Bill received a public hearing, where public employee associations, unions and the Massachusetts Municipal Association all voiced their disagreement with the Bill. The Bill died in committee when the Legislature concluded its session. Our Committee met with our local State Representatives and they agreed to re-file this bill. The bill was re-filed on September 10th, 2015.

Recommendation #21

Coalesce with other Triple A rated towns to organize legislative delegations.

In speaking with State officials, it was clear there is no appetite to take up serious OPEB reform at the State level. The Town's powers to address this OPEB crisis are limited. Reforms such as House Bill 59 and giving more power back to Municipalities to manage its OPEB responsibilities are necessary. The Board of Selectmen and Town Manager should work with other municipalities to organize legislative action to address OPEB reform.

Feedback from Public Hearing Meeting (March 24, 2016)

On March 24, 2016 the OPEB Committee conducted a public hearing to allow any interested party to express opinions related to the Draft OPEB Advisory Committee Report. This meeting was attended mostly by current and former Andover Employees, including teachers, first responders, town workers, administrators, etc.

Several common themes emerged in the public hearing and are worthy of recognition in this report. It is this Committee's opinion that the majority of these points had been surfaced by the Committee and other faithful attendees during our past meetings. And, we are confident that these considerations are embroidered into the fabric of our report. Nonetheless, they are worthy of specific mention and future consideration. These themes include:

Maintain trust by honoring past commitments.

To many employees who dedicated years of service with the understanding that they would receive affordable life-time healthcare, any change is a violation of trust. We would suggest that the need for cost cutting changes was not caused by the employees, nor was it caused by a misrepresentation by the Town. Overall healthcare costs have risen by over 70% from 2000 to 2013, while the expectations for investments have declined. These facts demand that leadership representing all stakeholders come to the table with balanced and fiscally responsible solutions. Beginning the negotiating process without recognizing the need for cost cuts, or to dismissing the affects these cuts have on people, would both be equal violations of trust.

Limit the impact on the most vulnerable.

The desire to limit the impact on the most vulnerable recipients has been a common theme expressed by numerous employees. And, it has been a view this Committee deeply respects. The "most vulnerable" have typically been defined as the oldest recipients and those with the smallest pensions. One of the challenges with this approach, however, is that the recipients with the smallest pensions may also have contributed the fewest hours/years of service. Although we recognize this potential unfairness, we wholeheartedly support any efforts to minimize the impact on those most vulnerable.

Recognizing that retirees as a whole may be the most vulnerable among us, sharing retiree healthcare costs with current employees has also been voiced. This option is expressed in our creation of the "Spanos Bill" outlined earlier in this report. Implementation of cost sharing measures would take extreme leadership and would require a guarantee that all savings are truly used to fund retiree healthcare.

Ensure cost savings are dedicated to OPEB.

Employees want to ensure that the cost savings of implementing these recommendations are actually applied to OPEB and not used to fund other town needs. In order to envelop all of the recommendations in Goal #2 (Economic and Strategic), the Committee crafted this into a formal recommendation and inserted it as Recommendation #20.

Share the burden with the Town.

Various options supporting this theme have emerged including increasing the Town's contribution and raising taxes through an override. This Committee recognizes the need to increase the Town's contribution and has recommended a substantial increase in Town funding (Recommendation #1). In combination with cost cutting measures, increasing the Town's contribution can significantly reduce the OPEB liability and help bring a balanced solution to the OPEB crisis.

It is also this Committee's opinion that overrides and selling assets are themselves unsustainable and, therefore, may not provide the long-term solution all stakeholders' desire. The Town must develop a long-term, sustainable approach to OPEB benefits. This plan must then have the appropriate funding incorporated into the general budget in order to eliminate unfunded OPEB liabilities.

With the significant rise in healthcare costs and a volatile return on investment, eliminating the unfunded OPEB liability will require a substantial sacrifice by all Stakeholders. Yet, achieving this goal will insure that, "all Andover children... enjoy the same privileges and opportunities we have had as Andover citizens" (*taken from Preface*).