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risk. Most private companies that still offer pensions offer “defined contribution” plans. One familiar example is the 401 (k) plan. Here there is no guarantee of the amount of retirement benefit; only that contributions are made according to the plan’s provisions. The plan member assumes the market risk associated with the account’s investments. A 2010 study by Towers Watson, a leading global professional services company, showed that of the 100 largest U.S. corporations, only 17 offered defined benefit plans. Most corporations have determined that they cannot afford the costs and risks associated with defined benefit plans.

12. In 2008, TCERA lengthened the “smoothing period” used for recognizing investment gains and losses on their books from five to ten years. This was done as a direct result of substantial losses of assets during the recent financial crisis. This means that large annual losses (the worst were suffered by the Plan in 2008-2009) will adversely affect the reported funded ratio of the Plan for ten years. *It also means that for the first several years after a large loss the unfunded ratio is in effect understated.*
13. Tulare County’s employee contributions to their pension plan are currently lagging the contributions made on their behalf by the County. According to the AV Report dated 6/30/2010, for the fiscal year ending on 6/30/2011 the recommended **average** employee contribution rate is 7.80% of salary. The recommended contribution rate for the County is 12.39%. The County also made payments on pension obligation bonds of about 2.5% of salaries. These fifteen-year bonds were issued in 1997 and generated \$45 million that was contributed to the Plan. The County is also contributing 7.65% of salaries to employees Social Security Insurance accounts. (Employee contributions are affected by age, years of service and type of employee)

CONCLUSIONS

1. The projections used in the AL Study seem to the Grand Jury to be grossly overly optimistic. An anticipated market return of 7.9 % is one that the Plan’s own investment advisor has said is much too high. California’s two largest pension funds, California State Teacher’s Retirement System (CalSTRS) and California Public Employees Retirement System (CalPERS), have reduced their projected investment returns because of perceived market changes. Pension plans do this very reluctantly because it necessitates larger sponsor contribution rates.
2. The Plan’s funded ratio will drop precipitously over the next eight years, even if TCERA’s current projections for investment returns are realized. This is because TCERA has recently adopted a “smoothing period” of ten years (formerly five years) used in reporting gains and losses to assets. The significant market losses of the Plan’s assets during the recent financial crisis will not be fully accounted for in the funded ratio until 2018. It is unwise to travel a path that, even if a 7.9% investment return can be realized, and the County can somehow increase its annual contribution rate from \$23 million to \$68 million, results in a funded ratio of 75.9% in 2018. It is impossible for the Grand Jury to see how the Plan recovers from this position, even if the ratio falls no further than to 75.9% by 2018. It is more likely than not that the ratio will fall to less than 75.9% over the next ten years.

3. As alarming as the Plan's current position is, many nearby counties have even deeper problems. According to a 2010 report from Fresno County's Grand Jury, Fresno County is projected to exceed contribution levels of 52% of salaries by 2013. Furthermore, as is the case in our own county, this is in addition to a contribution to employees' Social Security accounts of 7.65%. Fortunately, relative to some nearby counties, Tulare County has been more conservative in granting pension benefits in the past. We must also realize that without major changes, the County's pension costs will soon spiral out of control. The current path is unsustainable.
4. As pressures mount for more and more Tulare County contributions, sources for these costs will need to be found. Other County services will further suffer. A broadening burden will be born by all Tulare County residents in order to continue to secure funding for pension plan participants. Already, in many parts of the country, situations like this are resulting in serious political and social unrest.

RECOMMENDATIONS

1. A ten year plan should be put in place that targets a fully funded (100% funded ratio) plan by the fiscal year ending 06/30/2022. An assumption for investment returns in this new plan for the years 2012-2022 should be 5.4%, in accordance with Wurts and Associates current ten year forecast. Other currently used actuarial assumptions, including a 4% inflation rate, can be used. This plan will more accurately reflect the County pension plan contributions that will be needed if those contributions are the only remedy for the shortfall. TCERA and the Tulare County Board of Supervisors can then consider other changes that can be made to share the burden with the County. Some ideas for these changes appear in the balance of our recommendations.
2. Tulare County should negotiate with employee representatives, where necessary, to assure that employees' contributions will be, in any given year, at least equal to the County's contributions. This is in line with the most generous private defined contribution plans.
3. Although benefits earned to date must, and should, be honored, Tulare County should partner with employee representatives to balance pension benefits and employee contributions for future service to levels that are sustainable without putting at jeopardy other County services. Retirement age for full benefits, currently at 57 for most employees, and at age 50 for Public Safety Employees, should be considered as part of the discussions.
4. Pension benefits for new hires should be reset at levels sustainable without putting at jeopardy other County services. An even better alternative for new hires, and one that is fair to all County residents, is a defined contribution plan, with a contribution from the County. *(The Grand Jury recognizes that a plan conversion for new hires would result in a short term increase in the county's financial obligation, but the long term benefit to the county should far outweigh this temporary increase.)*

REQUIRED RESPONSES

Tulare County Board of Supervisors

Tulare County Employees Retirement Association

Tulare County Administrative Officer