Meeting No. 460

MINUTES OF MEETING

OF THE BOARD OF DIRECTORS

RETIREMENT SYSTEM OF THE TENNESSEE VALLEY AUTHORITY

March 3, 2016

A special-called meeting of the Board of Directors (Board) of the TVA Retirement System (System) was held on Thursday, March 3, 2016, at 9:40 a.m., CST, at the TVA Nashville corporate offices, Highland Ridge Tower, 535 Marriott Drive, OCP 6 201, Nashville, Tennessee.

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The following directors were present: Allen E. Stokes, Chair (via telephone); Anthony L. Troyani, Vice-Chair; Brian M. Child; John M. Hoskins (via telephone); James W. Hovious; Leonard J. Muzyn; and Tammy W. Wilson (via telephone). Also present were Patrick D. Brackett, Executive Secretary; Pamela K. Ramsey, Assistant Secretary (via telephone); and W. Colby Carter, Senior Counsel, Retirement Benefits & Compliance (via telephone).

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460-1. Directors Child, Hoskins and Wilson called this special meeting of the Board pursuant to Article II, Section 2 of the System Bylaws. Each director was notified in an email dated March 2, 2016, of the special-called meeting to be held on March 3, 2016. A copy of the notice from the Executive Secretary is filed as Exhibit 460-1.

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460-2. Prior to the meeting, the Board reviewed and discussed TVA's pension proposal to the Board as well as several potential counterproposals developed by individual Directors with information received from the Board's actuary, Mercer Human Resources Consulting. The Board labeled the counterproposals presented for discussion Proposals #1-5. Proposals #1-5 are attached as Exhibit 460-2.

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460-3. Director Child made a motion to approve amendments to the TVARS Rules and Regulations and 401(k) Plan Provisions as set forth in the term sheet of Proposal #5. As a part of this motion, the Board also would do the following:

- Direct the Executive Secretary to present this term sheet to TVA as a counterproposal to TVA's pension proposal to this Board dated December 16, 2015;

- Direct the TVARS staff to draft the amendments implementing the terms of this counterproposal, which will then be reviewed by (i) the TVARS Board, (ii) Mercer, who is the TVARS actuary, and (iii) Bradley Arant Boult Cummings, who is TVARS outside legal counsel; and

- Direct the Executive Secretary, once these amendments have been fully reviewed and finalized, to formally present them to TVA for its review, at which point the amendments would go into effect after 30 days if TVA does not veto them as set forth in the TVARS Rules.

The motion received a second from Director Hoskins. The term sheet of Proposal #5, with changes effective as of October 1, 2016, is as follows:

<u>Cash Balance to Defined Contribution</u>

Hired on or after 1/1/96 with less than 10 years of service: Transitioned to 401(k) only plan with 6% automatic contributions from TVA and 100% match on up to an additional 6% of employee contributions.

Hired on or after 1/1/96 with 10 or more years of service: 3% cash balance pay credits on future earnings, 3% automatic 401(k) contributions from TVA, and 75% 401(k) match on up to an additional 6% of employee contributions. TVARS Board will pursue allowing these employees to forego future cash balance pay credits and switch to 401(k) only plan with 6% automatic contributions and 100% match on up to an additional 6% of employee contributions.

Hired before 1/1/96: No change and will continue to accrue 6% cash balance pay credits. TVARS Board will pursue allowing these employees to forego future cash balance pay credits and switch to 401(k) only plan with 6% automatic contributions and 100% match on up to an additional 6% of employee contributions.

Election Option to Switch/Transfer: The TVARS Board will pursue adopting additional amendments to the TVARS Rules and Regulations and 401(k) plan that will offer employees in the cash balance structure the option to voluntarily switch their future participation to the 401(k) only plan with 6% automatic contributions from TVA and 100% match on up to an additional 6% of employee contributions. This voluntary election may also include the additional option to allow employees to transfer their existing cash balance accounts to the 401(k) plan. This election option and implementing amendments may be submitted by TVARS to the IRS for review and approval pursuant to an IRS private letter ruling and may take 1-2 years.

Fixed Fund

No additional fixed fund contributions for employees hired on or after 1/1/96 with less than 10 years of service or any employee electing to forego future cash balance pay credits by switching to a 401(k) only plan.

Lump Sum Payout

Lump sum payout option of cash balance account increased from $30,000 to total account value at termination/retirement, including lump sum payout of supplemental benefit (supplemental benefit lump sum calculated at 6% discount rate).

Reduced Interest Crediting Rate

Cash Balance

Hired before 1/1/96: No change on interest crediting rate for existing and future cash balance pay credits.
Hired on or after 1/1/96: No change on interest crediting rate for existing cash balances. Lower minimum interest rate on future cash balance pay credits from 6% to 4.5% (CPI + 2% instead of CPI + 3%, max rate of TVARS projected return less 0.5%).

Fixed Fund

All participants: Lower minimum interest rate for existing and future fixed fund contributions from 6% to 4.5% (CPI + 2% instead of CPI + 3%, max rate of TVARS projected return less 0.5%).

COLA Salary Cap

COLA only applies to pension amounts based on earnings up to Executive Level IV (former TVA salary cap). Additionally, no COLA for SERP or similar to SERP non-qualified deferred compensation participants with 10 years or less of actual TVARS service.

Supplemental Benefit Caps & Eligibility

No change from current rules as to required age and years of service (vested with 10 years of service and age 55). No more accruals of service toward benefit for employees hired on or after 1/1/96 with less than 10 years of service or any employee electing to forego future cash balance pay credits by switching to a 401(k) only plan.

10 or more years of service: Cap of $12.36 per month per year of service/Cap of $140.00 per month. May continue to accrue additional years of service at capped rates.
Less than 10 years of service: Cap of $12.36 per month per year of service/Cap of $140.00 per month prorated based on current service.

Raise COLA Eligibility Age

Raise age COLA begins from 60 to 65 for employees and retirees under age 50.

Maximum COLA

Maximum COLA increased to 6% with floor of 0%. COLA formula is modified to provide CPI less 0.25%. COLA is a vested benefit.

Contributions

Greater of minimum formula or $300 million annually for 20 years or until fully funded.

If funded status is less than 80% (under the actuarial rules applicable to TVARS (ASC 960)), any lump-sum cashouts will be paid by TVA instead of utilizing TVARS assets. Any such payments by TVA are in addition to the annual contribution amount.

TVA will have the ability to prepay equivalent contributions.

TVARS Board will have the ability to suspend contribution requirements upon super-majority approval of the TVARS Board (5 votes).

Governance

Changes to the TVARS asset allocation policy will require a super-majority approval of the TVARS Board.

Improve retiree representation on TVARS Board (7th director must be TVA retiree).

Amend TVARS Rules and Regulations to provide that, pursuant to TVARS Board policies, the TVARS Board may initiate disciplinary actions toward a director for violation of Board policies up to and including removal of the director from his/her position on the TVARS Board. Removal would require super-majority approval of the TVARS Board.

Provide members right to seek judicial enforcement of TVARS Rules and Regulations.

Require a super-majority approval of TVARS Board to change 401(k) plan contribution amounts.

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460-4. Director Muzyn made a motion to amend Proposal #5 as follows: the annual minimum calculation formula would have the unfunded liability amortized over 20 years, and any gains or losses over 7 years. According to Mercer, this would result in an average annual minimum contribution of $353 million over 20 years but a little heavier weighted on the front end. The motion received a second from Director Hovious. After discussion, the motion to amend failed by a roll call vote of 4 to 3. Directors Child, Hoskins, Stokes and Wilson voted against the motion to amend, and Directors Hovious, Muzyn and Troyani voted for the motion to amend.

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460-5. Director Muzyn made a second motion to amend Proposal #5 as follows: in the annual contribution formula, which would be the greater of the minimum formula calculation or $300 million for the next 20 years or until fully funded, “fully funded” would mean fully funded with an asset allocation that de-risks the plan. The motion received a second from Director Hovious. After discussion, the motion to amend failed by a roll call vote of 5 to 2. Directors Child, Hoskins, Stokes, Troyani and Wilson voted against the motion to amend, and Directors Hovious and Muzyn voted for the motion to amend.

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460-6. Director Troyani made a motion to amend Proposal #5 as follows: with regard to the proposal to increase the age at which the COLA begins from age 60 to age 65 for employees and retirees under age 50 as of October 1, 2016, exempt from this change employees and retirees who were first hired prior to January 1, 1996, who are in the Original Benefit Structure. The motion received a second from Director Muzyn. After discussion, at the request of the Chair, the Board went into executive session at 9:59 a.m. in order to discuss this pending motion to amend.

The executive session ended at 10:03 a.m. After further discussion, the motion to amend failed by a roll call vote of 4 to 3. Directors Child, Hoskins, Stokes and Wilson voted against the motion to amend, and Directors Hovious, Muzyn and Troyani voted for the motion to amend.

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460-7. After discussion, the original motion set forth in Minute Entry 460-3 passed by a roll call vote of 4 to 3. Directors Child, Hoskins, Stokes and Wilson voted for the motion, and Directors Hovious, Muzyn and Troyani voted against the motion.

<u>Director statements submitted regarding the vote</u>

Statement of Director Child:

As I am sure is true for all of the members of the TVARS Board, I have received numerous comments, both via email and in-person, from employees and retirees giving their 2 cents on TVA's pension proposal ever since it was sent to us on December 16, 2015. I have read every email and listened to the comments of each and every person that sought me out, and but for those that were vulgar, disrespectful, or threatening, I am genuinely appreciative of the feedback.

The feedback that I received certainly ran the spectrum—from those asking that the proposal be immediately rejected on its face to those asking that the proposal be accepted and implemented as expeditiously as possible. There was no consensus request in the feedback that I received, but there were two prevailing themes—the first of these being that our retirement plan is significantly underfunded, and the second being that no matter what a given person may think the answer or solution to addressing the underfunded status may be, this is a deeply emotional issue. I agree with both of these themes.

As of the fiscal year end, our plan had assets of $6.8 billion versus liabilities of $12.8 billion. There are many things that this Board does not agree upon, but I believe we all agree that this is not the level of funding we want. While we could debate or lay blame as to how the plan got to this level of funding, I largely believe such conversations to be a waste of time in that they do nothing to put us on the path of having the stronger and better funded system that I believe we all want.

There are undoubtedly some that think the solution to the funding issue is as simple as TVA, either immediately or over time, making the necessary contributions to return the system to fully-funded status. I certainly wish the answer was that simple, and I for one am confident that TVA would do just that if it was. I do believe that increased funding is a component of the solution, but I likewise believe that those who think the answer to be that simple either do not understand or are in denial about the challenges our industry is facing—challenges such as flat to declining loads, the growth of distributed generation, and the increasing rate competitiveness needed to attract and/or retain customers. Given such, I believe that creating a healthier system for the benefit of all participants will require both consistent and increased contributions to the plan over the long-term along with minimal changes to future benefits shared across all participant groups.

I believe this counterproposal strikes the appropriate balance and puts our plan on a path to achieving our shared goal of a fully-funded system over the next 20 years. Under this proposal, retirees will enjoy a COLA that is clearly vested, longer-tenured employees will largely retain their existing benefits, mid-career employees who are currently in the cash balance structure will have the ability to continue accruing pension benefits for the duration of their TVA careers, and newer employees in the cash balance structure with less than ten years of service will be able to participate in a 401(k) plan that is competitive if not simply generous. This proposal will also require TVA to make annual contributions equal to the greater of $300 million per year or the required minimum contribution as calculated under the TVAS Rules for the next 20 years or until the plan is fully funded.

I referenced earlier that the second prevailing theme from all the feedback that I received was one of emotion. Undoubtedly the pension funding issue has been a stress to many, including this Board, for a considerable time, but I think it is fair to say that the proposed changes from TVA put this issue on the radar for many others. I believe all parties need certainty and closure on this issue. While there are many paths that this Board could take, the one that I find unconscionable is to kick the can down the road and cross our fingers that the issue will solve itself. I truly wish it were that simple, but I do not believe it is, and I believe that to be a gamble that would simply be irresponsible for this Board to take.

I believe it is our responsibility to the 23,000+ retirees and 10,000+ active employees to be a part of the solution rather than an ongoing part of the problem by doing nothing. I believe the changes contained in this counterproposal are a reasonable compromise among TVA, TVARS, and TVA employees and retirees that focus on modest and mutual sacrifice for the long-term health and stability of our retirement system. Accordingly, I urge all of you to vote to approve this counterproposal.

Statement of Director Hoskins:

I believe this proposal provides a good, competitive retirement benefits structure for current TVA employees while simultaneously securing a vested cost-of-living adjustment for retirees. I vote yes to support this proposal.

Statement of Director Hovious

This so-called “agreement” to cut over $700 million in benefits from TVARS members breaks numerous commitments. Upper level TVA executives have rammed these benefit cuts down the throats of the people who did and who do the real work in making TVA successfully operate. Unfortunately at this point, legal action will be required to nullify this so-called “agreement”. The Federal Courts will need to step in and force TVA to honor commitments that have been made to TVA workers and retirees.

Statement of Director Muzyn

I voted against the amendments to the rules passed by a 4-3 vote on March 3, 2016. These were approved again by the same 4-3 vote on May 9, 2016, modified by some of the changes set forth in an April 18, 2016 letter to the board from Mr. Johnson. The May 9, 2016 amendments are scheduled to take effect on October 1, 2016. These comments remain very relevant to these later amendments.

I voted against these amendments because they reduce earned benefits the board has determined are vested. They also authorize TVA to inadequately fund the remaining benefits for the next 20 years. They reduce benefits by about $700 million. Even after this reduction, actuarial projections indicate that the 20-year funding requirements will not be enough to fully pay the remaining benefits. In addition, these amendments transfer significant stock market risk to the plan’s beneficiaries while giving the board the authority to suspend TVA’s contributions to the plan for any reason. TVA will still be able to terminate the plan at any time.

TVA’s agreeing that the remaining COLAs are vested gives the beneficiaries nothing because the rules clearly state that the retirement board determines what benefits are to be paid. The board has already determined and informed the court hearing the pending lawsuit that COLAs are vested benefits. Passage of these amendments could benefit TVA in defending against the lawsuit because it makes the board appear weak and inconsistent.

Without these amendments, a funding requirement averaging $353 million over twenty years would be required per our actuary. I do not believe this level of funding would be onerous to TVA and its rate payers. That averages $53 million dollars more a year than is contained in this proposal, and I was more than willing to negotiate the timing of these payments from TVA. Unfortunately, this process was about meeting TVA’s demands and not about negotiation and compromise.

I made several suggestions a few years ago to better protect lower income beneficiaries if a majority of the board insisted on reducing vested benefits over my objections. These included reducing COLAs only on pension payments above adjusted core amounts, eliminating COLAs completely for those receiving the separate executive pension, and suspending COLAs for retirees while they are receiving payments from TVA for contract work. Unfortunately, these suggestions were dismissed by a majority of the board and were not incorporated in these amendments. I am pleased that a suggestion I made a few years ago to increase the maximum COLA was incorporated in these amendments.

Statement of Director Stokes:

The TVA Retirement System was created in 1939 with a balance of power between the TVARS Board and TVA. The benefits and funding provided under the TVARS Rules can only be changed with the approval of TVA. TVA cannot initiate changes to the Rules but has veto power over any amendments adopted by the TVARS Board. It takes the two working together to effect change. The only unilateral action TVA can take to initiate change is to terminate the System. TVA's CEO and the TVA Board have both said that some action must be taken. If the TVARS Board does not act, then I fully believe that TVA will.

We've received many comments that say reject TVA's proposal and require TVA to contribute more money. Rejecting TVA's proposal forces them to take draconian unilateral action and this Board cannot require TVA to contribute more money or change the funding rules without TVA's approval.

We've also received more constructive feedback that supports our negotiating something a little better or a little different. The changes we are proposing to TVA today do just that. First, these changes provide retirees better inflation protection with the COLA benefit, preserve the benefit structure and some benefit levels for longer-tenured employees, provide mid-career employees a choice of two generous retirement benefit structures, and provide newer employees with less than 10 years of service one of the industry's best 401(k) benefits with a 12% contribution, which based on our projections, will result in very high income replacement at retirement. Second, these changes will increase funding to the System by raising the annual required minimum contribution from TVA. Finally, while these changes will slightly lower the COLA benefits for all employees and retirees, these COLAs will become a vested benefit and receive guaranteed funding.

When COLA benefits were added to the Rules in 1968, they were prefunded just like the pension benefits. In 1974, when ERISA was enacted for private-employer plans, the Rules were amended to ensure that TVA would guarantee the funding of pension benefits. However, COLA benefits were treated differently and became a "pay as you go" benefit and became funded on that basis. In addition, language was added in Section 11 of the Rules so that in the event TVA terminated the System, or TVA made less than the minimum contribution, and there were not enough assets to pay COLAs, they would only be paid if TVA determined that it is feasible for TVA to make additional contributions to pay COLAs. These changes being approved by the

TVARS Board today will vest the COLAs, require TVA to start prefunding those benefits, and in the event of plan termination, those COLA benefits will have to be funded and paid just like annuities and pensions.

I have always believed that some sort of negotiated agreement on COLAs between the TVARS Board and TVA was going to be necessary. It has never been my understanding from discussions with the Board's legal counsel that the position we have been taking on COLAs in the lawsuit in any way would prevent the Board from discussing a potential compromise on COLAs in its negotiations with TVA or block the Board's ability to approve such a compromise if one was reached. In the event the courts in the current lawsuit finally determine that the COLAs as originally structured are a vested benefit that couldn't be changed, then the TVARS Board will restore COLA benefits to all affected members and retirees consistent with the courts' rulings.

This has not been a pleasant process and I do not enjoy making benefit changes. But the consequences of doing nothing are severe. I've received many harassing emails and some threats and I expect after this action I will receive more, but based on the current situation and the options available, I believe this is the right thing to do and that these changes together as a whole are in the best interest of the System and its members and retirees.

For these reasons, I am voting in favor of the amendments set forth in this proposal.

Statement of Director Troyani:

I believe that this counterproposal balances the benefit reductions equitably among the members. However, I have a great concern that this would have an effect on the on-going litigation. So unfortunately, I'm going to have to vote no.

Statement of Director Wilson:

Good morning, I have been involved in some capacity with TVARS since 2008. I have been fortunate to serve at TVA for over 25 years and am fortunate to serve at such a great institution. We appreciate the feedback that we have received from numerous members of the System and have taken all feedback into consideration.

I appreciate the history that many of you shared regarding the prior decisions made by TVA and the TVARS Board. While I appreciate the history, I also realize that it doesn't change where we are. While I wish we could turn back the clock and make different decisions, with 20/20 hindsight, that is an impossible request.

I want each member to understand that that this Board has contributed numerous hours and consideration into the decisions we are making today. I respect each of my fellow Board members and their opinions. I also appreciate my fellow board members in the leadership and professionalism they have demonstrated in the face of threats and criticism through this process.

I believe, that in the situation we are in, the answer to do nothing is not in the best interest of the long term financial longevity of this System. I believe the TVARS Board has negotiated in good faith for the best interest of our members. I encourage each member of this System to continue to educate themselves on the Rules and financial status of this system and encourage them to always seek both sides of the story.

My entire career is invested in TVA and what makes TVA great are our employees and retirees and our Mission to Serve. As I have seen many times, I am hopeful that our work force will show resilience and band together as they typically have done in challenging times. It is imperative that we work together to continue TVA's legacy of greatness for years to come.

I vote yes.

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The meeting was adjourned at 10:17 a.m., CST.

Executive Secretary

Chair