Meeting No. 476

MINUTES OF MEETING

THE BOARD OF DIRECTORS OF

THE TENNESSEE VALLEY AUTHORITY RETIREMENT SYSTEM

June 15, 2018

[*Edited to remove personal information of members and retirees and proprietary or other confidential information pursuant to TVARS Confidentiality Policy*]

The regular quarterly meeting of the Board of Directors (Board) of the TVA Retirement System (System) was held on Friday, June 15, 2018, at 2:13 p.m., EDT, at the TVA Chattanooga Office Complex, MR 1N 403, Chattanooga, Tennessee.

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The following directors were present: Brian M. Child, Chair; Tammy W. Wilson, Vice Chair; Samuel J. DeLay; Christopher L. Hinton; James W. Hovious; Leonard J. Muzyn; and Allen E. Stokes (via telephone). Also present were Patrick D. Brackett, Executive Secretary; William B. Jenkins, Jr., Assistant Secretary; Sally R. Weber, Manager, Retirement Operations; Chris A. Stinnett, Sr. Analyst, Investment & Risk Management; and W. Colby Carter, Senior Counsel.

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476-1 Each director was notified in a memorandum dated June 7, 2018, of the regular quarterly meeting to be held on June 15, 2018. A copy of the notice from the Executive Secretary is filed as Exhibit 476-1.

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476-2 (A-6517). The Chair reported to the Board that on May 3, 2018, the System received a favorable private letter ruling from the IRS that allows the System to offer members with cash balance accounts the election option to receive future retirement benefits in the 401(k) Plan only and also to transfer their cash balance account to the 401(k) Plan. The Chair thanked the System staff for their work in making this election option possible for members.

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476-3 (A-6518). There were no items to report from the Executive Secretary.

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476-4 (A-6519). There were no items to report from the Senior Counsel.

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476-5 (A-6520). The Board noted its previous notational action approving a 1-year renewal of the System's fiduciary liability insurance policy for the Board and System staff from AIG with $10 million in coverage, subject to a $500,000 deductible. A copy of the insurance policy renewal quote from AIG and the insurance application and policy is filed as Exhibit 476-5.

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476-6 (A-6521). The Board tabled the approval of the minutes of Meeting No. 473 held March 29, 2018, pending the submission of additional Director statements on meeting items in the minutes.

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476-7 (A-6522). The Board approved the minutes of Special-Called Meeting No. 474 held April 27, 2018.

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476-8 (A-6523). The Board tabled the approval of the minutes of Special-Called Meeting No. 475 held May 23, 2018, pending the submission of additional Director statements on meeting items in the minutes.

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476-9 (A-6524). The Board accepted the Treasurer's Report for the quarter ended March 31, 2018. A copy of the Treasurer's Report is filed as Exhibit 476-9.

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476-10 (A-6525). The Board accepted the Investment Performance Report prepared by Wilshire Associates Incorporated (Wilshire) for the quarter ended March 31, 2018. A copy of the Investment Performance Report is filed as Exhibit 476-10.

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476-11 (A-6526). The Board accepted the report of retirements approved for the quarter ended March 31, 2018. A copy of the report is filed as Exhibit 476-11.

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476-12 (A-6527). The Board accepted the quarterly review for the TVA Savings and Deferral Retirement Plan (401(k) Plan) prepared by Fidelity Investment Institutional Services Company (Fidelity) for the quarter ended March 31, 2018. A copy of the 401(k) Plan quarterly review is filed as Exhibit 476-12.

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476-13 (A-6528). The Investment Committee report consisted of the items reported below at A-6529, A-6530, A-6531, and A-6532, and of the following items:

- The Board was provided and took note of the quarterly report on investment policy statement non-compliance items. A copy of the report, dated March 31, 2018, is filed as Exhibit 476-13(a).

- The Board was provided and took note of information regarding asset allocation and investment manager asset transfers during the first quarter of 2018. A copy of this information is filed as Exhibit 476-13(b).

- The Board was provided and took note of information on due diligence meetings and conference calls between System staff and investment managers and service providers for the period March 2018 through May 2018. A copy of the information is filed as Exhibit 476-13(c).

- The Board was provided an update on the funded status of the System through March 2018. A copy of the asset liability monitor report is filed as Exhibit 476-13(d).

- The Board reviewed and discussed the quarterly 401(k) Plan Discussion Guide from Aon, the System's 401(k) Plan consultant, covering the following: market information, performance of the investment funds in the 401(k) Plan's lineup, manager updates, and fee analysis. On May 23, 2018, the Investment Committee met with Aon and the System staff to review the quarterly 401(k) Plan Discussion guide, which included a detailed review and analysis of the 401(k) Plan's managed account services and investment advisor, Fidelity Strategic Advisors, compared to other managed account providers. A copy of the Guide, including managed account review, is filed as Exhibit 476-13(e).

- Under the System's asset allocation policy, there is a target of 5% for private credit and 10% for private real assets. On May 23, 2018, Wilshire's private market consultants provided the Investment Committee with a private credit and private real assets portfolio update, including strategic implementation portfolio construction over the next 4 years and potential manager recommendations in the pipeline for consideration. A copy of Wilshire's private credit and private real assets portfolio update is filed as Exhibit 476-13(f).

- On May 23, 2018, the Investment Committee was provided a pension plan risk exposure and analysis performed by Bridgewater, one of the System's investment managers. A copy of Bridgewater's pension plan analysis is filed as Exhibit 476-13(g).

- Under the System's asset allocation policy, there is a target of 17.5% for safety-oriented fixed income. At its March 29, 2018, quarterly meeting, the Board approved the termination of the core plus fixed income investment mandate and portfolio managed by Stone Harbor Investment Partners (see Minute Entry 473-14). On May 23, 2018, the Investment Committee discussed with Wilshire and the System's investment staff possible new investment mandates with Stone Harbor within the System's safety-oriented fixed income allocation. No action was taken. A copy of Wilshire's memo to the Board on Stone Harbor is filed as Exhibit 476-13(h).

- The Board was provided an annual review of the System's securities lending program with Bank of New York Mellon, the System's master trustee and provider of securities lending services (BNY Mellon). A copy of this report from BNY Mellon is filed as Exhibit 476-13(i).

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476-14 (A-6529). On May 23, 2018, the Investment Committee met and discussed with Wilshire's private market consultants, and the System investment staff, manager recommendations for the implementation of the System's investment allocation of 5% to private credit. After discussion, and upon the recommendation of Wilshire and the Investment Committee, the Board approved Cerberus Capital Management (Cerberus) as an investment manager of the System for private credit and a $35 million commitment to the Cerberus Corporate Credit Fund (Credit Fund), and authorized the Executive Secretary to take any actions necessary to implement the appointment of Cerberus and the investment in the Credit Fund. A copy of a memo from Wilshire to the Board on Cerebus is filed as Exhibit 476-14.

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476-15 (A-6530). On May 23, 2018, the Investment Committee met and discussed with Wilshire's private market consultants, and the System investment staff, manager recommendations for the implementation of the System's investment allocation of 5% to private credit. After discussion, and upon the recommendation of Wilshire and the Investment Committee, the Board approved Crestline Investors (Crestline) as an investment manager of the System for private credit and a $35 million commitment to the Crestline Specialty Lending Fund II (Lending Fund), and authorized the Executive Secretary to take any actions necessary to implement the appointment of Crestline and the investment in the Lending Fund. A copy of a memo from Wilshire to the Board on Crestline is filed as Exhibit 476-15.

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476-16 (A-6531). On May 23, 2018, the Investment Committee met and discussed with Wilshire's private market consultants, and the System investment staff, new manager recommendations for the System's investment allocation of 10% to private real assets, 15% of which is targeted for energy investments. After discussion, and upon the recommendation of Wilshire and the Investment Committee, the Board approved Quantum Energy Partners (Quantum) as a manager of the System for private equity energy investments, a $25 million commitment to the Quantum Energy Partners VII fund (Fund), and a $2.5 million commitment to the Quantum Energy Partners VII co-investment fund (Co-Investment Fund), and authorized the Executive Secretary to take any actions necessary to implement the appointment of Quantum and the investments in the Fund and Co-Investment Fund. A copy of a memo from Wilshire to the Board on Quantum is filed as Exhibit 476-16.

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476-17 (A-6532). As a part of its private real assets allocation, the System currently has a private real estate investment as a limited partner in the Kennedy Wilson Real Estate Fund IV (KW Fund). The KW Fund currently holds a 15% interest in the Kohanaiki Shores in Hawaii (Kohanaiki), which is the last remaining investment interest of the KW Fund. In order to facilitate the wind-down of the KW Fund, the general partner of the KW Fund has informed the KW Fund limited partners, including the System, of two liquidation options for consideration and approval, one of which is to sell the KW Fund's interest in Kohanaiki to Kennedy Wilson, an affiliate of the general partner and KW Fund's investment adviser. In presenting the two options, the general partner of the KW Fund provided the limited partners information on the proposals, including market valuation and investment return. After consideration of the proposal information, and following a discussion with Wilshire on the efficacy of the transaction, upon the recommendation of Wilshire and the Investment Committee, the Board voted to approve the sale of the KW Fund's interest in Kohanaiki to Kennedy Wilson in order to liquidate the KW Fund. A copy of the proposal information from the KW Fund general partner and Wilshire's analysis and recommendation to the Board is filed as Exhibit 476-17.

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476-18 (A-6533). The Retirement Committee report consisted of items reported below at A-6534 and A-6535, and of the following items:

- The Board was provided a copy of the IRS Private Letter Ruling dated May 3, 2018, with a favorable determination by the IRS on the proposed amendments to the System Rules and Regulations and 401(k) Plan Provisions that will allow those System members with cash balance accounts and benefits to elect to receive future retirement benefits through the 401(k) Plan only and also allow them to transfer their cash balance account value to the 401(k) Plan. A copy of the favorable IRS Private Letter Ruling is filed as Exhibit 476-18(a).

- Prior to the meeting, the Board reviewed with Mercer the preliminary results of the 5-year experience study for the System. As a part of the Retirement Committee, the Board further discussed the experience study results with Mercer, including various proposed assumptions as a result of the experience study. A copy of Mercer's experience study results for the System, dated June 15, 2018, is filed as Exhibit 476-18(b).

- The System staff provided and discussed with the Board draft versions of the following materials for the upcoming 401(k) voluntary election opportunity for System members with cash balance accounts and benefits: announcement e-mails, personalized statements, election guides, and communication and education session timeline. A copy of these election materials are filed as Exhibit 476-18(c).

- The Board was provided a letter from the TVA Retirees Association (TVARA) dated May 9, 2018, sent by DeWitt Burleson, TVARA President, to Bill Johnson, President and CEO of TVA, and Director Child as Chair of the TVARS Board, recommending that the TVARS Board consider and take two actions to improve the accountability and governance of TVARS. The Board discussed the recommendations in the letter. A copy of the TVARA letter is filed as Exhibit 476-18(d).

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476-19 (A-6534). At a January 23, 2018, special-called meeting, the Board previously approved the selection of Fidelity Benefits Consulting to partner with the Board and System staff to provide communication, education, and election services for the case balance elections to be offered eligible employees by the System. The Board was provided copies of the latest communication, education and election materials by the Executive Secretary. Given the Board's request to include statements of projected benefits, including monthly income, and expanded information in certain areas of benefits, the estimated cost of the project has increased from [*redacted*] to [*redacted*]. Following discussion, including requested changes to some of the materials, the Board approved the increased cost for the project with Fidelity Benefits Consulting. A copy of a memo from the Executive Secretary to the Board on the cash balance election window communications is filed as Exhibit 476-19.

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476-20 (A-6535). The following motion to amend Section 9B3 of the TVARS Rules and Regulations was placed on the agenda by Directors DeLay, Hovious, and Muzyn for discussion and consideration by the Board:

BE IT RESOLVED, that Section 9B3 of the Rules and Regulations of the TVA Retirement System is amended to add the language underlined as follows:

SECTION 9

9. Contributions to the System

B. TVA's Contributions

3. The "accrued liability" is the amount by which the present value of all benefits payable from contributions of TVA on account of all members and beneficiaries, as determined actuarially each year, exceeds the balance in the Accumulation Account as provided in section 10, and the present value of the aforesaid normal contribution to be made on account of such members during the remainder of their active service. Immediately following the valuation as of June 30, 1963, and following each annual valuation thereafter, the actuary engaged by the board shall compute the "accrued liability contribution," which shall be the percent of the total annual compensation of all members which, if paid over a period of 42 years

> beginning July 1, 1963, or the remainder thereof, would liquidate within such period the accrued liability as determined by the respective valuation. Provided, however, that for fiscal years after 2005, the "accrued liability contribution" shall be the percent of the total annual compensation of all members which, if paid over a period of 30 years, would liquidate within such period the accrued liability as determined by the respective valuation. Provided, however, that for fiscal years after 2016, the "accrued liability contribution" shall be a nominal contribution amount, which, if paid over 30 years, would liquidate within such period the accrued liability as determined by the respective valuation. <u>Provided, however, that for fiscal years after 2018, the "accrued liability contribution" shall be a nominal contribution amount, which, if paid over a 20-year closed amortization period, would liquidate within such period the accrued liability as determined by the respective valuation.</u>

After discussion, the motion to amend Section 9B3 failed by a roll call vote of 4 to 3. Directors DeLay, Hovious, and Muzyn voted for the motion, and Directors Child, Hinton, Stokes, and Wilson voted against the motion.

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

Statement of Director Muzyn:

Current TVARS Rules require the use of a rolling 30-year amortization period for the accrued liability. This is analogous to refinancing your house with a new 30 year mortgage every year so that you never have to pay off the loan. The March 2017 GAO report to Congress titled "Tennessee Valley Authority: Actions Needed to Better Communicate Debt Reduction Plans and Address Billions in Unfunded Pension Liabilities" states that TVA officials have told the GAO that TVA has a goal to fully fund its pension within 20 years. The report also states that that a 15 to 20 year closed amortization period, which will actually pay off the entire accrued liability within the 15 to 20 year period, is the maximum period recommended by a Blue Ribbon Panel commissioned by the Society of Actuaries.

A motion to approve this same rule amendment was made and seconded by Leonard Muzyn and Jim Hovious at the June 15, 2017 board meeting. A motion to table the vote on the proposed amendment "to allow for further discussion and analysis of the GAO report and given Mercer's current work analyzing the long-term funding policy of the System" was made and seconded by Brian Child and Tammy Wilson. The motion to table passed by a 4-3 vote. The board has now had a year to further discuss and analyze this rule amendment.

Further supporting the need for this rule amendment, the TVARS Investment Committee received a "Pension Plan Analysis" on May 23, 2018 from Bridgewater which stated that the pension plan only has a 60%-80% chance of being fully funded in 20 years using an optimistic 6%-8% average return. The current funding plan does not provide the certainty of full funding promised to the GAO and expected by retirees. The fiduciary role of the TVARS board requires the TVARS board to request adequate funding from TVA. Not requesting adequate TVARS funding would be negligent, and now a year and three months have passed since the GAO report was received.

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476-21 (A-6536). The Election Committee report consisted of the item reported below at A-6537, and of the following item:

- The Election Committee updated the Board on the number of applications received by the System from retirees who are interested in being considered for the 7th Director position. The window for requests to be received by the System from interested applicants will run through June 29, 2018.

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476-22 (A-6537). In response to the letter from TVARA, which included a recommendation for term limits to be established for TVARS directors, the following motion to amend Section 3(2) of the TVARS Rules and Regulations was placed on the agenda by Director Child as Chair for discussion and consideration by the Board:

BE IT RESOLVED, that Section 3(2) of the Rules and Regulations of the TVA Retirement System is amended to delete the language marked through and to add the language underlined as follows:

SECTION 3

3. Administration of the System

2. a. The board shall consist of seven members, three of whom shall be elected by and from the membership of the System, three of whom shall be appointed by TVA, and one of whom shall be a retiree selected by a majority vote of the other six. Except for the members of the initial board who were designated for staggered terms of one, two, and three years, respectively, the term of each director shall be three years. Each term shall be deemed to expire with the end of the day preceding the respective anniversary date of the establishment of the System, and all appointments and elections except those made to fill vacancies for unexpired terms shall be effective on such anniversary dates. Any vacancy on the board shall be filled by election or appointment, as the case may be, for only the unexpired portion of the predecessor's term.

b. As the term of each of the three directors elected by the membership expires or when a vacancy among such directors occurs, a successor shall be elected from such nominees as may be put in nomination by a petition subscribed to by not less than twenty-five members. Such election shall be by a majority of votes cast and, if no nominee obtains a majority in the initial balloting, a second vote shall be taken between the two nominees receiving the greatest number of votes in the initial balloting; provided, however, that when there are more than two nominees for a directorship, the board may in its discretion prescribe a form of ballot in which the voting members indicate the order of their preference among the various nominees and, if none of the nominees obtains a majority of first-choice votes among those cast, such order of preference shall be used in determining which of the two nominees receiving the greatest numbers of first-choice votes is elected. Ballots shall be distributed and received in such manner as the board shall determine to assure the integrity of the election. In the event only one person is duly nominated for the directorship to be filed, the board may declare such nominee elected without the necessity of formal balloting by the membership.

c. An individual is eligible to serve as a director of the board (either elected, appointed, or selected) no more than three full 3-year terms. Any partial term less than 3 years for which an individual has been elected, appointed, or selected under the provisions of this section 3(2) for the unexpired portion of a predecessor's term does not count toward this term limit of three full 3-year terms. Notwithstanding the above, any individual who has already served as a director for three full 3-year terms as of the effective date of this provision will be eligible to continue as a member of the board for the remainder of the director's current 3-year term.

~~c~~d. Notwithstanding the other provisions of this section 3(2), when a director, elected by and from the membership, ceases to be a member of the System, that individual also ceases to be a director and an election shall be held immediately to replace that director for the unexpired portion of that term except that elected directors whose membership in the System ceases during the last 9 months of their elected term or during the 9 months prior to March 4, 1994, shall remain members of the Board for the remainder of that term unless they withdraw their entire retirement allowance from the System, resign from the Board, or die.

~~d~~e. Notwithstanding the other provisions of this section 3(2), the board may initiate and enforce disciplinary actions against a director for violation of written policies formally adopted by the board, and such discipline may include action up to and including removal of the director from his or her position as a director on the board. A super-majority vote of the board (5 votes) is required for the removal of a director from the board pursuant to disciplinary actions under this subsection.

After lengthy discussion, Director Child made a motion to approve the proposed amendment to Section 3(2) of the TVARS Rules and Regulations. The motion received a second from Director Wilson.

Director Hovious proposed an amended version of Section 3(2)(c) within the proposed amendments that would grandfather all current directors under the proposed term limit as follows:

> c. An individual is eligible to serve as a director of the board (either elected, appointed, or selected) no more than three full 3-year terms. Any partial term less than 3 years for which an individual has been elected, appointed, or selected under the provisions of this section 3(2) for the unexpired portion of a predecessor's term does not count toward this term limit of three full 3-year terms. Notwithstanding the above, any individual who currently serves as a director of the board as of the effective date of this provision will be eligible to continue serving as a member of the board not subject to the term limit of this provision until such time as they are no longer elected, appointed, or selected, as a member of the board under this section 3.

After a discussion on the impact of this change, Director Hovious made a motion to approve the proposed amendment to Section 3(2) of the TVARS Rules and Regulations, with the amended subsection (c). The motion received a second from Director DeLay. The motion failed by a roll call vote of 4 to 3. Directors DeLay, Hovious and Muzyn voted for the motion, and Directors Child, Hinton, Stokes and Wilson voted against the motion.

Following this vote, Director Muzyn made a motion to table the vote on the proposed amendment to Section 3(2) indefinitely. The motion received a second from Director Hovious. The motion to table the vote indefinitely failed by a roll call vote of 4 to 3. Directors DeLay, Hovious and Muzyn voted for the motion to table, and Directors Child, Hinton, Stokes and Wilson voted against the motion to table.

Following action on the two intervening motions and additional discussion among the Directors, the Board voted on the original motion to amend Section 3(2), which passed by a roll call vote of 4 to 3. Directors Child, Hinton, Stokes and Wilson voted for the motion, and Directors DeLay, Hovious and Muzyn voted against the motion. A copy of a chart with the term history of each of the current Directors is attached as Exhibit 476-22.

Director statements submitted regarding the vote

Statement of Director Muzyn:

I voted against this term limit amendment because, though quite clever, I believe it is a very underhanded way to remove me from the board and obstruct employees and their elected directors in the exercise of their proper role in TVARS governance. TVARS was established in 1939 with a balance of employee and management representation and has operated for seventy-nine years without term limits. The term limit amendment will be much more of an impediment to employee-elected directors than to TVA-appointed directors. TVA-appointed directors can easily be selected by TVA for an unlimited number of partial terms, while employee-elected directors cannot. Of the current directors, I am the only one who is immediately disqualified from ever serving on the board again.

I am trusted by current and former employees, while employee surveys continue to indicate employee distrust of TVA executive management. I am trusted because I have been very honest and have communicated well with beneficiaries. I have kept members informed of developing issues which could significantly affect their retirement benefits. I introduced a funding amendment in this meeting to comply with the recommendations contained in the March 2017 GAO Report on addressing TVA's billions in unfunded pension liabilities. Complying with the GAO recommendations would require TVA to fund TVARS in line with best practices. My funding amendment failed by a roll call vote of 4 to 3. I am the only TVARS director possessing a depth of investment knowledge evidenced by the holding of a CFA (Chartered Financial Analyst) charter. Because I am trusted, well qualified, and have diligently performed my duties as a TVARS director, it would be very difficult to remove me without such a clever rule change.

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476-23 (A-6538). The Audit Committee report consisted of the item reported below at A-6539, and of the following item:

- The Board was provided and took note of a summary of charges on the System's credit card for the previous quarter.

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476-24 (A-6448). Upon the recommendation of the Audit Committee, the Board voted to approve, and authorized the Executive Secretary to execute, an engagement letter with Crowe Horwath to perform the fiscal year 2018 financial statement audits of the System and the 401(k) Plan. A copy of the engagement letter between Crowe Horwath and the System is filed as Exhibit 476-24.

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The meeting was adjourned at 3:14 p.m., EDT.

Executive Secretary

Brian M. Child

Chair