



SOUTHWEST POWER POOL FINANCE COMMITTEE MEETING

January 27, 2023
Videoconference

MINUTES

ADMINISTRATIVE ITEMS

SPP Chair Ben Trowbridge called the meeting to order at 1:05 p.m. The following members were in attendance:

Ben Trowbridge, Chair	SPP Director
Susan Certoma	SPP Director
Ray Hepper	SPP Director
Al Tamimi	Sunflower Electric Power Group
Sandra Bennett	AEP
Brad Cochran	OG&E
Mike Wise	Golden Spread Electric Coop
Matt Pawlowski	NextEra
Emily Koenig	Lincoln Electric System
Dianne Branch, Staff Secretary	SPP

Others attending the meeting:

Steve Osborn	Osborn, Carreiro & Associates
Lanny Nickell	SPP
Sheri Dunn	SPP

REVIEW OF ACTUARY ASSUMPTIONS

The purpose of the meeting was for the actuary to provide the Committee with further information on the changes to the recommended discount rate, specifically its financial impacts, and to provide additional information on the recommendation to use a new mortality table so that ultimately the committee could approve staff's recommended assumptions for the annual valuation.

Dianne Branch introduced SPP's actuary Steve Osborn of Osborn, Carreiro & Associates. Steve indicated that using the higher discount rate would offset some of the loss experienced in 2022

from overall lower returns on plan assets (approximately negative 14%). He stated that there is no impact to the cash contribution which is influenced by IRS guidelines. Staff emphasized that this change would have no impact to the net revenue requirement (NRR) in 2023 since the pension expense and the adjustment to the liability are non-cash items in the NRR calculation. Steve indicated that for his other clients, he has seen discount rates used from 4.75% to 5.25%. He added that based on the methodology that the committee has used in the past, 5.25% is appropriate and considers it to be reasonably conservative.

Steve provided an overview of the new recommended mortality table to be used in the upcoming valuation (Pri-2012). In recent years, SPP has used the IRS mortality tables for valuation of its retirement plan. Since the IRS updates its mortality tables annually to reflect improvements in life expectancy for that year, SPP has been changing the mortality table used in the valuation every year. The Pri-2012 table that is being recommended by Steve Osborn, assumes life expectancy continues to improve each year in the future and therefore doesn't require annual updating. Mr. Osborn indicated that the use of this table will have some impact on the calculation of the liability and the recommended contribution, but it was not deemed to be of concern by the committee. Mr. Osborn answered general questions from the committee to their satisfaction.

Several of the committee members with retirement plans shared that the assumptions being proposed by staff were in line with those being used for their company retirement plans.

In summary, staff is recommending four primary assumptions that are required for pension accounting and valuation: i) discount rate – 5.25% in accordance with SPP's process for determining the discount rate assumption (increased from 4% in 2022, ii) investment rate of return of 7.00% consistent with prior year, iii) rate of compensation change of 4.00% consistent with prior year, and iv) Pri-2012 mortality table based on actuary recommendation, which is a change from the previous IRS-2022 mortality table utilized in 2022.

Ray Hepper made a motion to accept the assumptions presented by staff. The motion was seconded by Mike Wise and approved by unanimous voice vote.

The meeting was adjourned at 1:30 p.m.

Respectfully Submitted,

Dianne Branch

Secretary



**SOUTHWEST POWER POOL, INC.
FINANCE COMMITTEE MEETING**

**January 27, 2023
(1:00PM-2:00PM CST)
Web-Ex**

AGENDA

1. Administrative Items (5 minutes)..... Ben Trowbridge
 - o Roll call
2. Discussion of Actuarial Assumptions (****ACTION****) (45 minutes) Steve Osborn

Antitrust: SPP strictly prohibits use of participation in SPP activities as a forum for engaging in practices or communications that violate the antitrust laws. Please avoid discussion of topics or behavior that would result in anti-competitive behavior, including but not limited to, agreements between or among competitors regarding prices, bid and offer practices, availability of service, product design, terms of sale, division of markets, allocation of customers or any other activity that might unreasonably restrain competition.

Memorandum

To: SPP Finance Committee
From: Dianne Branch
CC:
Date: January 12, 2023
Re: Actuarial Assumptions for Pension Valuation

SPP staff has been providing to the Finance Committee an early look at assumptions utilized in valuation of SPP's pension plan and post-retirement healthcare plan. This memo provides that look at the four major assumptions: discount rate, long-term rate of return, compensation change rate, and mortality tables.

Discount Rate: The process that SPP staff has been utilizing for determining the discount rate used in valuing pension liabilities and funding targets is generally based on the framework described in the Pension Protection Act of 2006 that utilizes the yield curve of investment grade corporate bonds (the top three rating tranches) averaged over twenty four months. These rates are subject to additional criteria and constrained by applicable percentage limits based on the 25-year average yield curve rates. The American Rescue Plan Act (ARP) and the Infrastructure Investment and Jobs Act (IIJA), both passed in 2021, introduced changes to the methods of determining the required interest rates and generally increased the applicable rate limits.

Also described in the Pension Protection Act of 2006 are three Segment Rates that can be used for the purpose of assigning a discount rate. These rates are differentiated based on the maturities of the corporate bonds underlying the yield curves used to determine each rate. The segments are broken down as follows:

1. First – zero through five years
2. Two – six through fifteen years and
3. Three – greater than fifteen years

In terms of evaluating the segment most appropriate for SPP's retirement plan, one of the most pertinent demographic points to consider is that the average age of the participants in the SPP plan is less than 45 years. This would indicate that major distributions from the plan should not begin occurring, on average, for another twenty years.

The Internal Revenue Service publishes periodic updates to segment rates throughout the year. The most recent update published December 2022 indicated post-ARP/IIJA adjusted average segment rates of 4.75%/5.00%/5.74%. SPP's actuary and independent auditor also provided feedback on the discount rates currently utilized by plans similar to SPP's and indices that measure rates used by a wider range of plans (Mercer Index Rates and FTSE Pension Liability Index) which point to a rate of 5%-5.25% that would be appropriate for SPP.

SPP used a discount rate of 4.00% in 2022 as well as in previous years. Based on most recent data on discount rates as explained above and the expectation that the current high-interest rate environment will continue into 2023, **SPP staff recommends using a discount rate of 5.25%.**

Long-term Rate of Return: The method used by SPP to assign the long-term rate of return is based upon an analysis of the long-term returns of widely recognized benchmark investments similar in asset allocation to the investments held in the pension plan trust. The benchmark returns are weighted based on SPP's desired asset allocation described in the Investment Policy Statement.

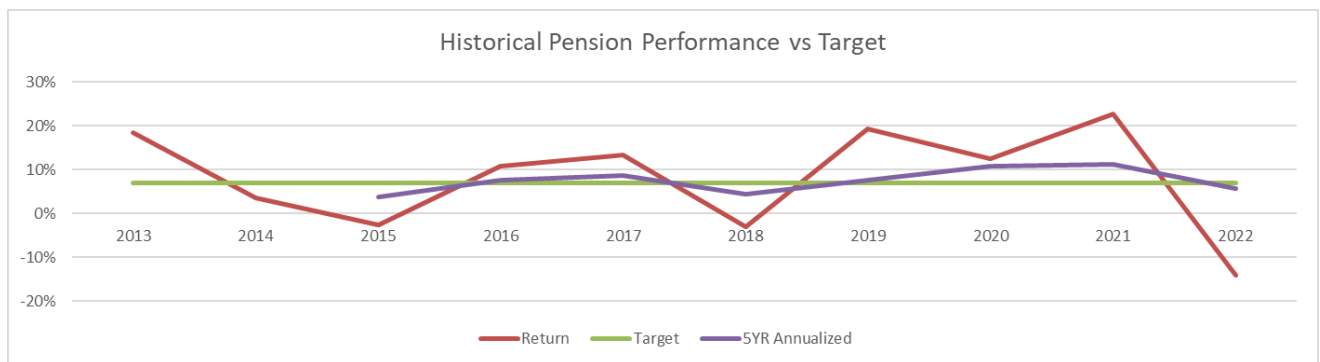
The Russell 3000 Index measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market. The Russell 3000 Index is constructed to provide a comprehensive, unbiased, and stable barometer of the broad market and is completely reconstituted annually to ensure new and growing equities are reflected. The



ICE BofAML Corporate 5-10 Year Index tracks the performance of U.S. dollar denominated investment grade rated corporate debt publicly issued in the U.S. domestic market. This subset includes all securities with a remaining term to maturity of 5 to 10 years.

	<u>Russell 3000</u>	<u>ICE BofAML Corp 5-10 Year Index</u>
10 Year Return (1/1/2013 – 12/31/2022)	12.13%	2.25%
Target Allocation	70%	30%
Weighted Avg. Return	8.49%	0.68%
Historical Expected Portfolio Return	9.17%	

SPP used a long-term rate of return assumption of 7.00% in 2022. **SPP staff recommends retaining the long-term rate of return at 7.00%.** The weighted average return on the benchmarks well exceeds SPP’s recommended rate of return for analysis purposes. Absent the large drop in equities in 2022, SPP believes the equity returns in the tail end of the 10 year review period have been abnormally high. Similarly, falling interest rates during most of the 10 year review period have served to drive up fixed income index returns abnormally. Maintaining the 7% long-term rate remains conservative even in light of the large negative returns experienced in 2022 and is also supported by the actuary. The chart below illustrates the plan’s actual annual returns versus the 7% target for the past 10 years.



Compensation Change Rate: SPP’s year over year growth rate in 2022 for compensation has exceeded the long-term growth rate of 4% SPP has used in its pension valuation however SPP expects compensation growth rate to slow. A 4% long-term growth rate is consistent with that used by many of SPP’s members in their pension plan evaluations. The compensation increase approved by SPP’s Human Resources Committee for 2023 is 4.25% in response to the high inflation environment and tight labor markets. **SPP staff believes retaining the 4.00% compensation rate change for the upcoming valuation continues to be appropriate from a long term perspective** as inflation and labor market pressures are expected to return to normal historical averages over the long term.

Pension Mortality Table: SPP has been using the IRS mortality tables for valuation of its retirement plan. The IRS updates its mortality tables annually to reflect improvements in life expectancy that year therefore SPP has been changing the mortality table used in the valuation every year. SPP’s actuary has proposed switching to a table which assumes life expectancy continues to improve each year in the future therefore doesn’t require annual updating, in particular the most recent Pri-2012 table. **SPP staff recommends using this table for the upcoming valuation.**



RECOMMENDATION

FINANCE COMMITTEE

JANUARY 27, 2023

PENSION AND POST RETIREMENT VALUATION

Approve assumptions to be used in the upcoming valuation for the pension and post retirement plans -

- Discount Rate – 5.25%
- Long Term Rate of Return – 7.00%
- Compensation Change Rate – 4.00%
- Pension Mortality Table – Pri 2012 table