[OPPD]

The Committee on Nebraska Retirement Systems met at 8:00 a.m. on Friday, April 5, 2016, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a briefing of the Omaha Public Power District retirement plans. Senators present: Mark Kolterman, Chairperson; Rick Kolowski; Brett Lindstrom; and Heath Mello. Senators absent: Al Davis, Vice Chairperson; and Mike Groene.

SENATOR KOLTERMAN: Good morning. Welcome to everyone. Our hearing this morning is to visit about the OPPD defined benefit plans, and we appreciate you being here this morning. I'll introduce the staff. We have Katie Quintero, who is our...what do you do, Katie? (Laughter)

KATIE QUINTERO: Committee clerk.

SENATOR KOLTERMAN: She's our clerk. And we have Kate, who is our legal counsel. Brett Lindstrom is from Omaha. We have Rick Kolowski from Omaha. Heath Mello will be joining us shortly. I'm Senator Kolterman. I'm from Seward. And Senator Groene will not be with us this morning, nor will Senator Davis. We have Jay, who is our page, and he'll be taking your blue sheets. And the way we'll do this is we'd like whoever is testifying to come forward and spell your name and turn in a blue sheet, and then make your presentation. And then we'll ask questions. So I think we'll just get started.

EDWARD EASTERLIN: (Exhibits 1, 2, 3, 4) My name is Edward Easterlin, E-d-w-a-r-d E-a-s-t-e-r-l-i-n. Good morning, Chair Kolterman, members of the committee. As I mentioned, my name is Edward Easterlin. I'm vice president and chief financial officer with the Omaha Public Power District. I appear before you this morning to provide an overview of OPPD's 401(a) defined benefit retirement plan as it relates to LB759 and Section 32-2401 of the Nebraska Revised Statutes. The district has supplied the documents and information requested by Senator Kolterman on March 16, 2016, and I'd like to apologize for the need of the request, and OPPD commits to filing the related documents in the future, as required by statute. The retirement plan governance is provided by OPPD board of directors and senior management within the company. The board of directors provide Strategic Directive 14, which dictates the board's expectations for the plan administration, which includes requirements to use an actuary to complete annual reviews, and a consultant to determine the discount rate, and contribute 100 percent of the annual required contribution each year. The board of directors also approve the retirement plan investment policy and the board also provides investment performance oversight on a quarterly and annual basis. An internal corporate policy documents how the plan is administered, including the actuarial standards that are used in determining the annual required contribution. The retirement plan performance is also monitored through several additional ways. Investment manager performance is measured by an external consultant so we have someone who monitors each investment manager and compares the fund itself to an index that is selected to determine the performance that they are achieving. An internal OPPD investment committee reviews the retirement plan performance quarterly, and the committee meets with each investment manager on an annual basis for a face-to-face meeting to discuss the performance of the plan and their outlook for future market and investment strategies. External auditors also audit the plan annually. Just to point out other plan disclosures occur in several other ways. The annual report that we produce each year contains detailed information on the plan, including information that quantifies the liability and funded status of the plan. Disclosures regarding the plan are included in official statements that's used to offer OPPD debt offerings and sales. The retirement plan reports are distributed to employees and retirees on an annual basis. We began that process in 2013. It communicates the plan return, the liability, and the funded status. And finally, I'll just point out that OPPD has funded 100 percent of the plan's annual required contribution over the last 30 years. With that, I'd be willing to take any questions that you have. [OPPD]

SENATOR KOLTERMAN: Well, first of all, again, thank you for coming. It's not our intent to cross-examine you and give you a hard time, but we had to send the letter that we sent because of statute. And you've been very good to work with since we sent the letter. We appreciate that. I have just a couple of questions. Then I'll open it up to the rest of the committee. Just out of curiosity, who is your actuarial consultant? [OPPD]

EDWARD EASTERLIN: We use Aon Hewitt. [OPPD]

SENATOR KOLTERMAN: Okay. And then was there an actuarial study conducted to determine the cost of closing the defined benefit plan and, if so, what were the costs? Have you ever looked at that? [OPPD]

EDWARD EASTERLIN: There were studies that were completed looking at the difference between what I'll call defined benefit and the cash balance plan. I was not a part of those. Those studies predate me. I joined the organization in 2009 and so I don't have firsthand information. I can find out that information for you. [OPPD]

SENATOR KOLTERMAN: Okay. Just it was more out of curiosity. [OPPD]

EDWARD EASTERLIN: Okay. [OPPD]

SENATOR KOLTERMAN: It looks like in 2015 you changed the amortization period on the pension plan from 15 to 20 years. Why was that done and what was the amount of the funding impact on the plan? [OPPD]

EDWARD EASTERLIN: There were two underlying reasons to consider changing the amortization period. Actually, I'll just mention that we had looked in the past at what's typical for a public entity to use for amortization period and we found it typically falls between 15 years and 30 years. And so we were amortizing over a 15-year period. We are currently using a discount rate of 7.75 percent, and we determined that rate in 2011 and included in the 2011 actuarial report and estimates. Given the last couple of years and the returns, we have considered, for two reasons: number one is the market has not been as kind to us as it had been in the past, and also from a frequency standpoint we felt that every four to five years we probably should look at redoing the asset liability study. And so we have...we've begun the process to do that. The thinking is that the discount rate could be further reduced from the 7.75 percent. And if that occurs then that would actually increase the annual funding amount. So in anticipation of that, and also combined with some revenue shortfalls that we experienced in 2015 at the company, as well as increasing pressure on the 2016 budget, we looked at what the impact would be for increasing the amortization period from 15 to 20 years and then also rolling in a reduction in the discount rate. And so it was a combination of things that led to going from 15 years to 20 years. The overall effect is it would allow us to keep the funding fairly well level and also factor in a lower discount rate. [OPPD]

SENATOR KOLTERMAN: And so are you right in the middle of an experience study? [OPPD]

EDWARD EASTERLIN: We're doing an asset liability study. I'll distinguish the experience study from the asset liability study. As we understand it, at least the way we refer to an experience study, we're looking at the assumptions that go in relative to what experiences we've had over the past. We don't use that to determine the discount rate. We use what's called an asset liability study. So we look at what our liabilities are and the time frame in which we need to make those payments in the fund...or out of the fund. And then we look at our investment portfolio and the structure of it, given the returns of each type of investment that we hold or potentially could hold. And we work with our consultant, in this case it's Segal Rogerscasey, to come up with what the reasonable expectation is for each type of investment that we hold and then the risk of that overall investment, not only to individual security standpoint but as an overall portfolio. And so we're looking at the expected return and the correlation of those returns to come up with what the risk is for the portfolio. So what we're trying to do is minimize the risk while having an acceptable level of return. And so we call that an asset liability study and we do that to come up or identify what we think the appropriate discount rate is. I will point out that the discount rate itself is not expected to be the return that you're going to receive over the next year. The discount rate is the return you expect to see over a longer period of time. It is an average.

And as we know, the market is volatile and it does not move in a straight line. And so just to give you a point of reference, if we looked over the last seven years, our average return has been 9.23 percent. If we look over the last 30 years, it's been 8.7 percent. Now in the short term, that hasn't been the case because for last year we were negative 1.07, and for three years we were 4.77. So it's a long-term view of what you think the market would provide for the type of portfolio that you're investing in. [OPPD]

SENATOR KOLTERMAN: And you have two plans. You have Plan A and Plan B. It looks to me that there's a huge discrepancy between the two. Can you give me any indication of why that is? [OPPD]

EDWARD EASTERLIN: Well, we have a defined benefit pension plan and then we have two OPEB plans. [OPPD]

SENATOR KOLTERMAN: Correct. [OPPD]

EDWARD EASTERLIN: So the OPEB plans are structured differently. There's Plan A, which basically provides retiree benefits after retirement for employees that started with the organization prior to 2008. And in that plan we fund the liability of that plan and we started funding that in 2006. Prior to 2006, we were on a pay-as-you-go basis, as was most organizations. And then the accounting standards changed that required organizations to recognize that liability and reflect it in their financial statements. We did that beginning in 2007, but we started funding in 2006. That plan basically provides retiree healthcare and life insurance benefits that are equal to the benefits that are available to our employees. Okay? That's Plan A. [OPPD]

SENATOR KOLTERMAN: Okay. [OPPD]

EDWARD EASTERLIN: Plan B, which is available for employees hired after 2007, that plan basically caps the liability for the company. In other words, it looks at when an employee is hired and it deposits a certain amount of money, basically $10,000, into an account for that employee. It adds an additional $1,000 per year of service, and then applies an interest rate. That employee, when they retire, then have those funds available to pay for deductibles and copayments on insurance. So their benefit is limited to the amount of funds that's available upon retirement. The other fund is basically including any increases in healthcare that occur. [OPPD]

SENATOR KOLTERMAN: Okay. [OPPD]

EDWARD EASTERLIN: That's the difference between the two. [OPPD]

SENATOR KOLTERMAN: Questions? Go ahead, Brett...or Senator Lindstrom. [OPPD]

SENATOR LINDSTROM: Thanks, Chairman. Thank you, Mr. Easterlin, for being here. I notice in 2015 the return was, I believe, negative 1 percent, which is about average with, give or take, 100 basis points of what I assume. What specifically is the allocation or the makeup of the overall portfolio? And what percentage do you have in alternatives within that portfolio, if you have that information? [OPPD]

EDWARD EASTERLIN: Sure. Just to make sure I don't recall something incorrectly, let me pull out my sheet here. So we have 54 percent of a fund in equity and 46 percent in fixed income. [OPPD]

SENATOR LINDSTROM: Okay. [OPPD]

EDWARD EASTERLIN: So it is a fairly conservative fund. When we look at the equity, we have 24 percent in large cap, 7 percent in mid cap, and 23 percent in international equity. On the fixed income side, we have 30 percent in domestic fixed income and 16 percent in global fixed income. So we don't have any alternatives. [OPPD]

SENATOR LINDSTROM: Not at this point. Okay. And you said you met...you meet with the investment managers on an annual basis. How many managers do you have and are they separately managed accounts, are they ETFs, or...? [OPPD]

EDWARD EASTERLIN: They're separately managed accounts. The exact number I'm going to say, I'm going to ask, can I phone a friend? Can I have a lifeline here? (Laughter) Is there ten? [OPPD]

_______________: There's eight if you count these couple that we have; two (inaudible). [OPPD]

EDWARD EASTERLIN: Okay. That's where. So we have eight managers. At least two of them have two different types of investment...investments with us. And so what we do is we have a meeting every six months and we bring in one group of investment managers during the first half of the year and then the other investment managers come in at the last half of the year. So we meet with each one of them on an annual basis. [OPPD]

SENATOR LINDSTROM: How often will you, I guess, fire a manager and hire a manager? Do you look at how they've done the last three years, five years? How much time do you give them before you reassess what you're doing? [OPPD]

EDWARD EASTERLIN: We look at three and five years. [OPPD]

SENATOR LINDSTROM: Okay. [OPPD]

EDWARD EASTERLIN: And then based on their performance, if they're lagging the index and they're not within a certain percentile within that investment category, then we place them on watch and we watch them for about 12 months, and then we actually make a decision to replace that investment manager. We have one investment manager today that's on watch. [OPPD]

SENATOR LINDSTROM: Okay. Thank you, sir. [OPPD]

SENATOR KOLTERMAN: Other questions? Go ahead, Senator Kolowski. [OPPD]

SENATOR KOLOWSKI: Thank you, Mr. Chairman. Mr. Easterlin, thank you again for being here. I just...just a definition I wanted to get...understand the "terminated vested" listing that is on the sheet that you have here. What is that category, "terminated vested," compared to others? [OPPD]

EDWARD EASTERLIN: So if an employee...if the...if you have an employee who works for the company and they have met the vesting requirements of the plan, in other words, they've been with the company five years and then they separate from the company, they are vested and then they are terminated. So that represents employees who are no longer with the company that have earned or are vested in the retirement plan. [OPPD]

SENATOR KOLOWSKI: So in five years they could be considered vested over (inaudible)? [OPPD]

EDWARD EASTERLIN: Correct. [OPPD]

SENATOR KOLOWSKI: Thank you very much. [OPPD]

EDWARD EASTERLIN: So what's happened is they have left and their benefit retains with the...with the fund. [OPPD]

SENATOR KOLOWSKI: And when does that...when does that benefit kick in? At what age would they become eligible to receive funds? [OPPD]

EDWARD EASTERLIN: It would depend on how long they were with the organization and their age. So you go back to the point system. You know, if they reach the points of 75, they could be considered for retirement. Or if they have ten years of service and they're 62, then they can also be considered for retirement. [OPPD]

SENATOR KOLOWSKI: Okay. Thank you. Thank you very much. [OPPD]

SENATOR KOLTERMAN: Senator Mello, you have a question? [OPPD]

SENATOR MELLO: Yes. Thank you, Chairman Kolterman. Thank you, Mr. Easterlin. I apologize for being a little late. When was the last asset allocation study that OPPD conducted? [OPPD]

EDWARD EASTERLIN: 2011. [OPPD]

SENATOR MELLO: Okay. Is that kind of in concert with your experience study? [OPPD]

EDWARD EASTERLIN: No. We actually conducted an experience study in 2010. [OPPD]

SENATOR MELLO: Okay. [OPPD]

EDWARD EASTERLIN: And I believe we provided in our comments that we did not receive that information in writing but the results were reflected in the actuarial report in 2010. [OPPD]

SENATOR MELLO: Okay. And I see that you're in the midst of an experience study right now. Do you know when will be your next asset allocation study then? [OPPD]

EDWARD EASTERLIN: We are actually conducting an asset liability study presently, not an experience study. [OPPD]

SENATOR MELLO: Okay. Okay. [OPPD]

EDWARD EASTERLIN: And I mentioned earlier that we look at those two things differently. The asset liability looks at the liability to the portfolio and the payment, the liquidity needs that you're going to have to make retirement payments in the future, and then considers that relative to the investments that you hold in the portfolio and expected returns of those investment classes to then derive a discount rate with the correlating risk factor or standard deviation of that portfolio. The experience study looks at how your other assumptions are tracking with regard to the experiences that you've held over a period of time. [OPPD]

SENATOR KOLTERMAN: I have just a couple more questions. On your pension actuarial report, it includes a breakdown of male and female for average age, average years of service, and average entry age. But it doesn't provide information for male and female average pay. Is there separate information that we might be able to get data that would show what that is or do you track that at all? [OPPD]

EDWARD EASTERLIN: To my knowledge, I'm not aware of it. It's something that we could determine for you. I would imagine our HR group looks at that for diversity purposes, but I haven't seen the information. And if that's something you're interested in, we could take a look at it. [OPPD]

SENATOR KOLTERMAN: I was just curious when I looked at that and saw that. And then will you describe how the pay credits factor into the cash balance plan? [OPPD]

EDWARD EASTERLIN: The pay credits. The actual funding percentages? As on the cash balance plan, an employee contributes the same amount into the cash balance plan that they would contribute into the defined benefit plan, so that's 6.2 percent. So each employee is contributing 6.2 percent of their salary into the pension plan. Based on the employee's age and the number of points they have determines how much is actually deposited into that fund. So in other words, if an employee is contributing 6.2 percent and given their age and the number of points they have, their years with the company, the company would put in a corresponding contribution. And if it's 7 percent or 7 points, then the company would contribute .8. As the employee works longer, has more experience and becomes older, that percentage then increases over time. And I can't remember the exact cap on it but I want to say it's like 16 percent. [OPPD]

___________________: Yeah, it's 30 points after 16 percent. [OPPD]

EDWARD EASTERLIN: Yeah, 16. [OPPD]

SENATOR KOLTERMAN: Okay. Thank you. And finally, I guess I would just say obviously it looks like you're on top of this. I would like to compliment you for the fact that you've made your ARC payments consistently and the fact that you've reduced your assumed rate to 7.75 already. You're probably going to be looking at that to reduce it again, but then, again, that will create a larger ARC. You're aware of that. [OPPD]

EDWARD EASTERLIN: Exactly. [OPPD]

SENATOR KOLTERMAN: But looks to me like you're on the right track. It's just a matter of... [OPPD]

EDWARD EASTERLIN: Thank you. [OPPD]

SENATOR KOLTERMAN: ...having the market work with this a little better. [OPPD]

EDWARD EASTERLIN: Thank you very much. We try to make sure we understand the plan, the liability of the plan, and have a funding process and program in place. As I mentioned earlier, we have an internal document that basically, you know, management reviews it as to how we're going to fund the plan. And so it's all documented and we take it pretty serious. [OPPD]

SENATOR KOLTERMAN: I'm hoping that, well, it would be a huge undertaking if you moved outside of the statute by next year at 80 percent. So let's just plan on getting together next year and see how much we can improve it again. But we do appreciate you coming today and thank you. [OPPD]

EDWARD EASTERLIN: Thank you. [OPPD]

SENATOR KOLTERMAN: Any final questions from anybody? [OPPD]

SENATOR KOLOWSKI: I have one. [OPPD]

SENATOR KOLTERMAN: Oh, Rick, go ahead. Senator Kolowski. [OPPD]

SENATOR KOLOWSKI: Yes, sir. Thank you, Mr. Chairman. Mr. Easterlin, do you see any added employees with expansion of the programs within OPPD in the very near future? Anything percolating out there that we should know about? [OPPD]

EDWARD EASTERLIN: You know, we changed the plan design back in 2013 and all new employees who have entered the plan since that time are on the cash balance plan. [OPPD]

SENATOR KOLOWSKI: Uh-huh. [OPPD]

EDWARD EASTERLIN: So what's happening is the number of employees who have the defined benefit plan are decreasing over time as they retire and actually become beneficiaries or, excuse me, receiving payments from the plan. And the number of employees that are on the cash balance plan is growing. From a total number standpoint, I don't see a significant or a material change in the number of employees participating in the plan. [OPPD]

SENATOR KOLOWSKI: Asking the stabilization question on that. Thank you. [OPPD]

EDWARD EASTERLIN: Right. [OPPD]

SENATOR KOLOWSKI: Thank you very much. [OPPD]

EDWARD EASTERLIN: Yeah. Thank you. [OPPD]

SENATOR KOLTERMAN: So next year we'll probably have this hearing a little bit earlier. We'll try and schedule with the rest of them that are going to be coming in. That way you don't have...this is late in the session, I mean. But we do appreciate you coming this morning. We appreciate the prompt response that we received from your team and like to thank you. [OPPD]

EDWARD EASTERLIN: Yeah. Well, thank you for your patience and understanding. As I said earlier, we will provide the information on schedule. [OPPD]

SENATOR KOLTERMAN: All right. Well, have a safe trip back to Omaha, everyone. [OPPD]

EDWARD EASTERLIN: Thank you. [OPPD]

SENATOR KOLTERMAN: Thank you. The hearing is closed. [OPPD]