CPS ENERGY
MINUTES OF SPECIAL MEETING OF THE BOARD OF TRUSTEES
MEETING AS THE RISK MANAGEMENT COMMITTEE

Meeting held on December 6, 2019

A Special Meeting of the CPS Energy Board of Trustees meeting as the Risk Management Committee was held on Friday, December 6, 2019, in the CPS Energy Training Center located at 4514 Frank Bryant Lane, San Antonio, Texas. Chair Steen called the meeting to order at 1:00 p.m.

<u>Present were Board members:</u>
Mr. John Steen, Chair
Dr. Willis Mackey, Vice Chair
Mr. Ed Kelley
Ms. Janie Gonzalez (joined the meeting after it began)

<u>Also present were:</u>
Ms. Paula Gold-Williams, President & CEO
Dr. Cris Eugster, Chief Operating Officer (COO)
Ms. Carolyn Shellman, Chief Legal Officer (CLO) & General Counsel and Board Secretary
Mr. Fred Bonewell, Chief Security, Safety & Gas Operations Officer (CSSGO)
Ms. Felecia Etheridge, Chief Customer Engagement Officer (CCEO)
Ms. Vivian Bouet, Chief Information Officer (CIO)
Ms. Delores Lenzy-Jones, Chief Financial Officer (CFO) & Treasurer

CPS Energy Staff Members
City of San Antonio officials

I. SAFETY MESSAGE

The Board meeting began with a safety message delivered by Ms. Eunice Lopez, Interim Senior Manager, Enterprise & Public Safety, Security Safety & Gas Solutions.

II. PUBLIC COMMENT

No members of the public registered to speak, so there were no public comments.

III. INVOCATION AND PLEDGE OF ALLEGIANCE

An invocation and the Pledge of Allegiance were delivered by Ms. Lopez.

IV. CHAIRMAN'S REMARKS

Chair Steen did not provide remarks.

V. RISK MANAGEMENT COMMITTEE CHAIR'S REMARKS

At this time, Chair Steen turned over the meeting to Dr. Mackey, Chair of the Risk Management Committee, who proceeded with the Committee's agenda.

VI. BOARD GUIDANCE DOCUMENTS

Ms. Gold-Williams informed the Committee that management is currently reviewing numerous Board policies and will recommend further action on them at a future meeting.

Trustee Kelley commented that the Board receives a lot of materials and he appreciates that the experts, such as Ms. Gold-Williams and management, review the policies and raise any issues to the Board.

Ms. Gold-Williams stated that a Senior Chief or designee is responsible for reviewing and proposing future action on each Board policy; some policies may no longer be needed. Legal and Board Relations would also provide input on the recommendations to the Board. She made a commitment to consistently monitor the policies.

Chair Steen and Ms. Gold-Williams discussed potential updates to the Travel and Non-Travel Expense Policy and other Board policies and procedures. Ms. Gold-Williams noted that both policies and procedures would be considered in recommending future action on Board policies. In response to Dr. Mackey's request, she noted that attachments and forms would be included with the policies and brought back to the Board.

Trustee Gonzalez joined the meeting at this time.

VII. RISK MANAGEMENT COMMITTEE UPDATE

Mr. Cory Kuchinsky, Interim Vice President, Strategic Pricing & Enterprise Risk Management & Solutions, provided the Committee an update on Enterprise Risk Management Solutions (ERMS). He reviewed the alignment between multiple stakeholders and explained how CPS Energy considers different frameworks, such as those promulgated by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the International Organization for Standardization (ISO), when developing an ERMS framework, part of which entails evaluating risks and best practices.

Mr. Kuchinsky stated that in FY20, enhancements have been made to the risk mitigation plans (RMPs) for identified risks. The RMPs now address key drivers and funding status, measurably define success and consider gaps in plan design. They are "living" documents, continuously reviewed during the year. In response to a comment about ISO by Trustee Gonzalez, he stated that ERMS uses only those components from COSO and ISO frameworks that fit us best. Monthly touchpoints with risk owners ensure the flexibility to pivot. Dr. Eugster commented that a recent project involved the use of more than one framework. Ms. Lenzy-Jones stated that ERMS does not get stuck on any one framework, but rather triangulates several different vantage points, such as risk calibration by management. Ms. Gold-Williams added that RMPs are designed to be what is needed to make a change, but since horizons may shift, we focus on agility and the most effective and quickest mitigation. Trustee Gonzalez indicated that her concern was addressed.

Mr. Kuchinsky discussed the impact RMP development and execution have on internal controls. Ms. Jennifer Barrera, Manager of Internal Controls, recently joined the ERMS team to promote an increased understanding of internal controls throughout the organization, and ensure internal controls resulting from RMPs are identified and documented.

He also discussed how ERMS leverages key relationships with business units to make the risk management program successful. Mr. Shane Bemis, Interim Senior Manager, Generation Duty Office, highlighted an example whereby Power Generation and ERMS partnered on a combustible dust risk. The teams anticipated risks earlier to optimize mitigation strategy, enhance analytics, improve responses to deviations in critical component data, and improve collaboration, trust, and information-sharing. The resulting RMP includes a third-party engineering assessment to identify and prioritize projects in a multi-year phased approach. The combustible dust risk level has been reduced from “high” to “medium”.

The Committee and Mr. Shane Bemis, Interim Senior Manager, Power Generation, discussed the specific risk and RMP. Dr. Eugster clarified that Power Generation had existing risk mitigation efforts at the time that the RMP was developed. Combustible dust is a known issue in the industry and we worked with our property insurance carrier, FM Global, to gather information about best mitigation practices.

Ms. Gold-Williams pointed out that each CPS Energy power plant has its own risk profile. FM Global’s model looks at actual execution and best in class technology for each type of plant. In this case, FM Global’s input helped us to refine the combustible dust RMP. We keep refining the process addressing each plant based on its risk profile.

The Committee discussed the benefits of partnering with FM Global, including positive effects with the rating agencies, to develop and implement RMPs.

Mr. Bemis also briefed the Committee on the plant-specific risk registers used to mitigate risks on Power Generation assets. Asset 360 is a tool used to monitor plant-specific data to identify trends and proactively address risks.

Mr. Bemis and Mr. Kuchinsky reiterated the ways and benefits that collaboration with FM Global has reduced potential risk exposure. ERMS also engages in similar ways with our liability insurance carrier, Associated Electric and Gas Insurance Services, Ltd. (AEGIS).

In conclusion, Mr. Kuchinsky stated that ERMS plans to grow existing partnerships with business units and continue developing and executing on RMPs with an engaged management team.

The Committee and staff discussed the risk register and selected risks - cybersecurity and brand management.

VIII. BENEFIT PLAN REVIEW: DELIVERING VALUE

Ms. Debra Wainscott, Senior Director, People Services, began the benefit plan review by introducing Mr. Rob Appling of Wilshire Associates (Wilshire) and Mr. Jake Pringle of Milliman, consultants to the CPS Energy Pension Plan (Plan), who were present for the review.

Ms. Wainscott explained that the Plan is an important tool used to attract and retain highly-skilled, mid-career employees at all levels. One reason for that is that defined benefit pension plans are more prevalent in the utility industry. Thus, a good benefits plan, along with technical training and long-term development, is very important to keep employees engaged in the workforce.

Currently, the Plan is about 81 percent funded, which is relatively healthy compared to other Texas public pension plans. Chair Steen asked for additional perspectives about other Texas plans. Ms. Wainscott stated that many are less funded than our Plan, but there are some plans, primarily much smaller plans, that are funded at 100 percent.

Ms. Wainscott provided a snapshot of workforce demographics as of December 31, 2018, highlighting the utility industry’s shift as an increasing number of workers become eligible for retirement and retire. Thirty-seven percent of CPS Energy employees will be eligible for retirement within three years. Competition for science, technology, engineering and math (STEM) jobs in San Antonio remains fierce, with unemployment remaining steady at three percent, with some job types experiencing zero percent unemployment. She emphasized the retention of our skilled craft employees, noting that we invest more than eight years and more than $400,000.00 to "make" a proficient, card-carrying electric journeyman. A graph showing the development and progression of an overhead journeyman was distributed to the Committee.

In response to Trustee Gonzalez' question, Ms. Gold-Williams stated that approximately 10 percent of CPS Energy's workforce are veterans.

Ms. Wainscott highlighted that retention of employees with instrumentation and electrical (I&E) skills is critical since I&E easily transfer to other industries, creating many other job opportunities for them.

Trustee Gonzalez suggested alternate ways to retain millennials by providing pay increases throughout the year rather than only at year end.

In response to Chair Steen's inquiry, Ms. Lisa Lewis, Vice President People & Culture, explained the apprentice program used by CPS Energy and accredited by the United States Department of Labor (DOL). Chair Steen noted the challenge that when our employees receive their DOL card, they can use it to get another job elsewhere.

Ms. Wainscott showed a graph indicating the ages and tenure of retirement-eligible employees. Ms. Gold-Williams explained why utility employees often retire before the age of 60. She noted that, given the very physical and stressful nature of utility work, it is not reasonable to expect someone to do it for a very long period, such as 50 years. Utility employees in office positions can also encounter stress because of the changing industry.

Chair Steen shared a personal anecdote highlighting the round-the-clock work required of utility employees. He recognized that being away from one's family on holidays can take a toll on a person.

Ms. Wainscott reviewed the history and governance of the Plan. The Plan has been offered since 1982. It is a defined benefit plan that uses a formula based on age, years of service and average compensation to calculate a retiree's benefit. A graph showing the 10-year historical trend of active employee and retiree participants in the Plan was distributed to the Committee. Since 2015, the number of both active employee and retiree participants has steadily increased.

Ms. Wainscott provided information about vesting and pension payment options. She noted that very few retirees opt for a lump-sum payment; most select an annuity option.

Next, Ms. Wainscott reviewed the governance structure of the Plan and the responsibilities of the Board, the Employee Benefits Oversight Committee (EBOC), the President & CEO, and the Administrative Committee. She noted that the Administrative Committee meets three to four times per month and uses Wilshire as an investment manager and consultant. She explained the expected rate of return (EROR) as an example of a closely-monitored assumption.

The Committee and staff discussed a media story about the Plan that included only partial facts and led to confusion about the health of the Plan. Ms. Gold-Williams commented that the story allowed her to author an editorial and a letter to retirees with clarifying information.

In response to an inquiry from Trustee Gonzalez, Ms. Wainscott and Ms. Gold-Williams explained how employees and specifically journeymen are educated and informed about the Plan, their participation in it, Social Security and the voluntary 457 deferred compensation Plan. An awareness campaign in 2020 will focus on the value of the Plan, how it works and why employees should pay more attention to it.

Dr. Mackey suggested emphasizing early participation in the 457 and 403b plans. He shared his positive experience with early investing. Trustee Gonzalez suggested financial literacy as a possible focus.

Ms. Wainscott reviewed the investment performance of the Plan. Since 2016, Wilshire has provided investment guidance to the Administrative Committee resulting in several investment practice enhancements. In 2017, the Plan's asset allocation targets were updated to reduce risk and increase returns based on Wilshire's guidance.

Since Plan inception in 1983, Plan investments have returned 9.6 percent and 10-year returns are 9.4 percent. Year to date returns are approximately 13.5 percent.

Trustee Kelley commented that performance would be very different if the significant market downturn in 2008 were included in the 10-year returns. He stated that the 7.25 percent expected return on assets (EROA) is aggressive. Ms. Wainscott stated that we continue to closely watch the investment market and the EROA projection.

Chair Steen agreed that the EROA is a critical projection and requested information about it from Mr. Appling and Mr. Pringle. Mr. Appling and Mr. Pringle provided brief information about their backgrounds and experiences. Mr. Appling stated that determining the right EROA is a common topic with the governmental pension plans that he advises. The EROA is based on current valuations and updated every quarter. He noted the strong historical and year-to-date performance of the Plan and reminded the Committee that CPS Energy has lowered its EROA in a systematic way. At the time of a previous presentation to the Committee, CPS Energy's EROA was comparable to other public pension plans and was at the median EROA. Now, it is fair to say that returns have decreased in 2019 and there may be a desire to lower EROA another tick. Mr. Appling offered to provide an investment analysis for that decision.

Trustee Kelley and Mr. Pringle discussed the typical EROAs for corporations. Mr. Pringle highlighted that corporations use a different methodology to measure the liability so corporate and municipal EROAs are not comparable. Generally, corporate EROAs are in the 5.5 to 6 percent range. Mr. Pringle stated the median return of Milliman's long-term asset model is 6.25 percent.

Chair Steen asked whether it was time to decrease the EROA for the Plan. Ms. Gold-Williams commented that the Plan's EROA is not arbitrary; it is carefully and methodically considered and established based on key indicators. It was last evaluated during Summer 2019. If the EROA were not carefully determined, the impacts would be devastating because the more conservative or lower the EROA, the higher the necessary cash funding contribution from CPS Energy to the Plan. Ms. Gold-Williams reiterated that there are significant differences between corporate and municipal utility models. A municipal utility can take a methodical view down, but we cannot do some things that corporations can, such as bond buy backs or risk transfers. Our process is very planned.

Chair Steen asked why decreasing the EROA from 7.25 to 7 percent would be catastrophic. Ms. Gold-Williams responded that decreasing the EROA 25 basis points would increase company costs by approximately $70 million. She emphasized the sensitivity of the correlations between the EROA and the company's contribution to the Plan and offered to provide more information about it to the Committee.

Mr. Appling stated that he has another client that wanted to reduce their EROA 50 basis points, but they are doing it incrementally because of the funding impact. Mr. Pringle confirmed that a 7.25 percent EROA still falls within a reasonableness range.

Ms. Gold-Williams noted that an EROA decrease is catastrophic because it creates an immediate funding obligation that must be addressed.

Trustee Kelley discussed with Mr. Appling and Mr. Pringle the types of retirement options available at Wilshire and Milliman.

Ms. Wainscott reviewed benchmarking indicating that 77 percent of state and local governments and 53 percent of employers in the utility industry offer a defined benefit plan. In contrast, only 13 percent of private industry employers offer such a plan.

In conclusion, Ms. Wainscott noted the value the pension plan provides towards attracting and retaining employees.

IX. EXECUTIVE SESSION

At approximately 3:28 p.m., Dr. Mackey announced that the required notice had been posted and that the Trustees, with only necessary parties in attendance, would convene into Executive Session, pursuant to the provisions of Chapter 551 of the Texas Government Code, for discussion of the following posted item:

- Competitive Matters (§551.086)

The Board reconvened in open session at 4:04 p.m. Ms. Shellman reported that only Competitive Matters were discussed, and no votes were taken in Executive Session.

X. OTHER BENEFIT DISCUSSION

This item was not taken up.

XI. ADJOURNMENT

There being no further business to come before the Board and upon a motion duly made by Trustee Kelley, seconded by Trustee Gonzalez, and upon an affirmative vote by all members present, the meeting was unanimously adjourned at 4:04 p.m.

Carolyn E. Shellman

Carolyn E. Shellman
Secretary of the Board