FASB ROA Assumption
As of December 2015
12/31/15 Measurement & 2016 Cost Calculations

Background

The FASB expected return on assets (ROA) assumption is used by the Pension Plan and Retiree Benefits Plan (the "Plans") actuary (AonHewitt) in its determination of the annual retirement benefit expense projections.   This assumption is a long-term assumption and as such has not been adjusted frequently. The assumption should be monitored annually and changed if the observed returns deviate significantly from the current assumption, or if certain conditions change.

The evaluation of the reasonableness of the expected ROA assumption incorporates multiple data sets. Generally, those data sets are:

   I.   A "backward looking" historical rolling return analysis using historical returns for a portfolio with an overall equity & bond asset mix similar to the Plans', over rolling 10-year, 20-year, 30-year and 40-year periods;

   II.   A "backward looking" 1000 trial monte carlo, over a 30-year horizon, using historical returns, risk and correlations for a portfolio with an overall equity & bond asset mix similar to the Plans';

   III. a)   A "forward-looking" simulation of expected returns for a portfolio with an asset allocation similar to the Plans' as developed by the Plans' independent external actuary, AonHewitt. For further information, refer to the *NextEra Year-End 2015 Assumption Parameters* guide.

   III. b)   An active management premium reflecting the overall performance of the funds relative to an appropriate market benchmark as presented in the NextEra Year-End 2015 Assumption Parameters guide.

In addition to different models or capital market return assumptions, additional consideration can include past success relative to expected returns and other qualitative expectations.

For 2015, the Pension's approved targeted asset investment mix was unchanged from 2014 and is:

- 45% public equities
- 5% private equity
- 10% convertibles
- 5% real asset strategies
- 3% hedge funds
- 32% fixed income[1]

Process for 2016 cost calculations

Beginning with the 2016 cost calculations, the ROA is being set as a net of anticipated investment-related fees assumption. NextEra had historically set the ROA assumption with no adjustment for fees paid by the trusts as there has been an explicit assumption about those fees (outside of the scope of the return on assets assumption).   The new net of fee methodology is a common approach, according to AonHewitt. For further information, refer to the *NextEra Year-End 2015 Assumption Parameters* guide.

NextEra reviews the results of the historical returns, Monte Carlo analysis, Aon's forward looking simulation and active management premiums to support the selected rates in the Summary section below.

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[1] including approximately 50% in alternative fixed income strategies.

I. **Historical Rolling Returns**

It is an acceptable practice in the investment consulting community when developing long-term (i.e. 10 year or greater) forecasts of expected returns, to assume no return premium for international, mid- or small-cap equities and instead let the investment case for these assets reside on the diversification benefits.

In this vein, when examining historical returns to judge the appropriateness of the FASB ROA assumptions, it is reasonable to utilize the S&P 500 returns and US Core Bond Index (Barclays US Aggregate Bond Index) as they provide the longest historical data set – and length of time is deemed more important for this purpose than 'over engineering' the process through incorporating sub asset classes with significantly less historical data. The overall exposure to equity/bond beta is by far the more influential factor in determining returns.

For the "backward looking" analyses, a high level 55/45 equity-fixed allocation was utilized for the Pension, reflecting its 'effective' equity exposure. A 60/40 target policy mix of stocks and bonds was used for the RBP plan. The "backward looking" analysis views returns of market indices as reflecting a net of fee passive investment style, and therefore there is no deduction for fees.

The historical rolling return analysis draws on historical market returns from 1926 to 2014.

Summary results for the Pension are:

- The median return over the 80 10-year periods (that is the 10-years ending 12/10, 10-years ending 12/09, etc.) is 8.1%.
- Over 20-year periods, the median of the 70 periods is 8.6%.
- Over 30-year periods, the median of the 60 periods is 8.7%.
- Over 40-year periods, the median of the 50 periods is 9.1%.

Summary results for the Retiree Benefits Plan (RBP) are:

- The median return over the 80 10-year periods (that is the 10-years ending 12/10, 10-years ending 12/09, etc.) is 8.4%.
- Over 20-year periods, the median of the 70 periods is 9.1%.
- Over 30-year periods, the median of the 60 periods is 9.2%.
- Over 40-year periods, the median of the 50 periods is 9.3%.

II. **Historical Monte Carlo Results**

The Monte Carlo simulation draws on historical returns, risk and correlations from 1926 through 2014. This historical analysis views returns of market indices as reflecting a net of fee passive investment style, and therefore there is no deduction for fees.

- The simulation's 50th percentile return is 8.4% for the Pension.
- The simulation's 50th percentile return is 8.6% for the RBP.

III. a) **Forward Looking Simulation (E-tool)**

The plan's actuary, AonHewitt, has run a simulation based on the Plans' asset mix and their capital market assumptions. The underlying assumption regarding fees that is being made by

AonHewitt in its Forward Looking Simulation is consistent with a net of fee view - it assumes a passive style of investing in which fees are de minimus (that is, gross = net), except for certain alternative investments for which the e-tool return expectation is a net of fee expectation.

For the Pension, the AonHewitt simulated distribution of possible returns yields a median expected return of 6.8% with a 35th / 65th range of 7.6% - 5.9% based on the Q4 2015 assumptions.

For the Retiree Benefits Plan, the AonHewitt simulation yields a median expected return of 6.0%, with a 35th / 65th range of 6.8% - 5.2% based on the Q4 2015 assumptions.

III. b) Active Management Premium

The observed realized net of fee return fluctuates based on the period of time being examined and by plan.

For the Pension, data shows excess returns over its benchmark of 0.4% (3-years), 0.3% (5-years), and 0.2% (10-years).

For the Retiree Benefits Plan, data shows excess returns over its benchmark of 1.8% (3-years), 1.4% (5-years), and 0.7% (10-years).

Summary

The selected rates are 7.35% for the Pension and 7.2% for the Retiree Benefits Plan. It is believed the selected net of fee assumptions are reasonable long-term expectations when considering the Plan's historical observed actual results, the range of results of the "backward looking" analyses, and the e-tool results in conjunction with the active management premiums.

	Pension	RBP
I. Historical 10 year median	8.10%	8.40%
II. Monte Carlo 50th percentile	8.40%	8.60%
III. a) E-tool		
35th percentile	7.60%	6.80%
50th percentile	6.80%	6.00%
65th percentile	5.90%	5.20%
III. b) 3 year Active Mgmt Premium	0.40%	1.80%
Selected ROA	7.35%	7.20%