CALIFORNIA ISO

ATTACHMENT 1

INVESTMENT POLICY

(Amended June 2005)

DELEGATION OF AUTHORITY

Consistent with the Delegation of Authority from the Chief Executive Officer("CEO") to the Officers and Authorized Persons, initial investments with a particular broker/dealer or financial institution shall be authorized by the CEO. Thereafter, purchasesand redemptions of Authorized Investments through that entity may be made by the Chief Financial Officer ("CFO") and his or her designees ("Investment Directors.") under the authority granted for repetitive electronic transfers.

SCOPE

The Policy applies to the investment activities of the California ISO. This policy applies to the following funds:

This policy will not apply to investments of 401k employee retirement funds.

◊ California ISO Operating Reserve Funds;

◊ Operating Funds;

◊ Restricted Funds;

◊ Bond Proceed Funds;

◊ Debt Service Reserve Funds;

◊ Funds held by the ISO on behalf of the ISO Market or specific market participants, subject to the following: such funds will typically be invested only in high-quality money market mutual funds (as defined in this document) with the following potential exceptions:

1. With respect to funds held by the ISO from a single-entity (such as a collateral account), if that entity requests or authorizes in writing an investment in another investment permissible under this ISO investment policy, the ISO may agree to such an investment at its discretion and with the approval of the ISO CFO or CEO.

2. With respect to market related funds that potentially relate to more than one market participant, if the ISO determines that the funds are likely to be held for an extended time period, the ISO may invest such funds in a "AAA" rated U.S. Government Treasury or Agency Security of an appropriate maturity with the approval of the ISO CFO and CEO.

OBJECTIVES

Safety: Safety of principal is the foremost objective of the investment policies and practices. It is the responsibility of the Chief Financial Officer and any Investment Directors to ensure that all investments are made in accordance with existing laws, this Investment Policy, established departmental procedures, and any other restrictive agreements such as ISO bond agreements.

LIQUIDITY: Adequate cash to meet all payment requirements will be maintained. This objective will typically be made by matching the maturity dates of investments with planned disbursements and by maintaining adequate levels of liquid securities to meet unforeseen disbursement requirements.

EARNINGS: Investment Directors will seek to maximize returns on CAISO financial assets within the parameters this Investment Policy, and after the objectives of safety and liquidity have been met.

PRUDENT INVESTOR

Investments will be made with the same standard of care under the circumstances then prevailing that reasonable persons acting in a like capacity and familiarity would use in the conduct of the funds to safeguard principal and maintain liquidity.

INTERNAL CONTROLS AND REPORTS

Investment Directors will maintain a system of internal investment controls which shall be subject to review by CAISO's external financial auditor in connection with CAISO's annual financial statement audit.

DIVERSIFICATION AND PORTFOLIO MIX

CAISO will maintain a portfolio of authorized investments, as defined in this policy, with diversified maturities, issuers, and security types in order to avoid risks inherent in over-investing in any one sector. Portfolio holdings are limited as specified in the "Authorized Investments" section of this document.

Within the parameters defined in this policy, the CFO may establish and revise further guidelines or objectives for the portfolio mix.

MATURITY SCHEDULING

Investment maturities may be coordinated to meet projected cash flow needs, taking into account large routine disbursements as well as considering sizable receipts of funds.

COMPETITIVE BIDDING

Where appropriate, the Investment Director may obtain competitive bids or offers for a particular security.

SAFEKEEPING

All investment securities purchased by CAISO shall be held in safekeeping by CAISO or by an institution designated by the CAISO. The safekeeping institution(s) will be required to issue timely confirmation to CAISO listing the specific instrument, rate, maturity and other pertinent information. Payment for securities should normally be "Delivery Versus Payment".

SALE OF SECURITIES PRIOR TO MATURITY

Securities may be sold prior to maturity to meet CAISO cash needs, to realize profits, or to shift into alternative investments.

Losses on the sale of securities are acceptable under certain circumstances. For example, when the reinvested proceeds from the sale will provide income with greater present value than that of the instrument sold; when credit deterioration or decreasing market value is a concern; or when funds are needed to meet CAISO cash requirements. In all cases, the Investment Director will act in accordance with the prudent investor clause of this policy. Any losses on the sale of securities will be reported in the monthly financial report.

PORTFOLIO RISK MANAGEMENT

It is the responsibility of the CFO to anticipate and develop appropriate safeguards to address various types of investment-related risks:

<u>Risks:</u>	<u>Safeguards:</u>
Credit risk	• Credit rating agencies • Minimum rating levels • Credit analysis • Government regulations
Market exposure	• Diversification of maturities, security type, industry segments, and issuers
Regional/Industry exposure	• Analysis of regional and industry trends
Sovereign risk	• Analysis of international and political trends • Diversified foreign investments
Counter-party risk	• Approved and licensed dealers • Appropriate documentation

LEGAL COMPLIANCE

The CFO will ensure that all investment transactions are in compliance with this Investment Policy, and any bond indenture terms.

REPORTING

Annually, the CFO will submit a report to the Board of Governors providing the following:

a). A list identifying the type of investment, issuer, date of maturity, par and dollar amount invested on all securities. The market value and source of the market value information will also be provided.

b). A statement that the portfolio is in compliance with the Investment Policy or manner in which the portfolio is not in compliance.

PROHIBITED INVESTMENTS

- Any security which could result in an interest accrual of zero or less if held to maturity such as: a) inverse floaters; b) range notes, or c) interest-only strips derived from a pool of mortgages;
- Investments in equity securities;
- Investments in derivative securities (exclude interest rate swap agreements on California ISO debt approved by the ISO Governing Board.)
- <u>Securities which are ineligible to CAISO employees under the CAISO code of conduct.</u>

These prohibitions exclude:

(a) investments in mutual funds which may contain investments in these securities, if such securities constitute less than 5% of the net asset value of such funds.
(b) Investments in money market/mutual funds managed by affiliates of market participants, or investments procured from affiliates of market participants otherwise permissible under this investment policy that are procured through a competitive bidding process.

EXCEPTIONS

Exceptions to the dollar limits in these investment guidelines, which may become necessary due to special business circumstances, may not exceed an additional 5% of the portfolio limits specified in this policy, and must be approved in advance by the CEO and Finance Committee Chair with subsequent notice to the Governing Board. (For example, with such approval, the 45% limitation on GICs could be increased to 50%.)

Other exceptions which might be warranted by special business circumstances shall require the written consent of the ISO Finance Committee Chair or Chair of the ISO Governing Board.

The percent of portfolio limitations for investments set forth in the subsequent section of this document are “as of the date of the purchase of the investment”. Such limitations shall not require (but do not preclude) subsequent rebalancing of the portfolio and the liquidation of investments due to a decrease in the overall size of the portfolio.

AUTHORIZED INVESTMENTS

The following is a list of the currently approved securities, and any applicable restrictions:

Security Type	Restrictions
U.S. Treasury Bills and Notes	No Limit
Federal Agency Securities (i.e. FNMA, FHLB, Freddie Mac, SalliMae, Farm Credit, TVA, World Bank, etc.)	No Limit
Bankers Acceptances	• Banks with total assets of $1 billion or more and a credit rating within the top three ratings (without regard to modifiers) of a nationally recognized statistical rating organization "NRSRO" as defined by the Securities and Exchange Commission..
Commercial Paper (C.P.), Variable Rate Demand Obligations/Auction Rate Securities Medium Term Corporate Notes, and Asset-Backed Securities	For Commercial Paper (C.P.) / Variable Rate Demand Obligations/ (VRDO)/Auction Rate Securities • U.S.-Based issuers; minimum assets of $500 million • Credit rating of A1 and/or P1 or equivalent rating, or better,. • Not more than 10% of outstanding C.P. or VRDO of any single issuer. Other debt of the issuer, if any, must have a credit rating within the top three ratings (without regard to modifiers) of a nationally recognized statistical rating organization. For Medium Term Corporate Notes, VRDOs/Auction Rate Securities and Asset-Backed Securities: • Maximum maturity of 5 years (from date of purchase by ISO) • A credit rating within the top three ratings (without regard to modifiers) of a nationally recognized statistical rating organization. For C.P., VRDOs, Auction Rate Securities, Medium Term Corporate Notes and Asset-Backed Securities • On a combined basis, C.P.,, VRDOs, Auction Rate Securities, Medium Term Corporate Notes and Asset-Backed Securities shall not exceed 45% of the total portfolio. Allocation between the instruments may be based on funding requirements. The five year maturity limit noted above shall not apply to (1) variable rate securities with a periodic interest rate reset and a "put" feature for investors or (2) auction rate securities with a periodic interest rate set through an auction process. Such securities are equivalent to a liquid, short-term security for the investor.
Interest Bearing Demand or Time Deposits (including Negotiable Certificates of Deposit ("C.D."s)	• Issued by a national or state chartered bank, or state or federal Savings Association, or state-licensed branch of a foreign bank (1) with combined capital and surplus of at least $100 million dollars, or (2) fully insured by the Federal Deposit Insurance Corporation, or (3) secured at all times by collateral security consisting of U.S. Government Obligations or Federal Agency Securities.

Repurchase Agreements	• Third party safekeeping • Maximum term of one year • Collateral will be valued at least at 100% and adjusted at least quarterly. • Counterparty must be a primary dealer of the Federal Reserve Bank of New York.
Collateralized or uncollateralized investment agreements or other contractual arrangements (such as Guaranteed Investment Contracts-"GICs") With banks, insurance companies, or broker-dealers.	• Not more than 45% of total portfolio • Credit rating of senior long term debt of such bank, broker-dealer, or insurance company is rated within the top three rating categories (without regard to modifiers) by a nationally recognized statistical rating organization.
Mutual Funds (Debt only)	• Not more than 25% of total portfolio in short to intermediate-term bond funds holding investment grade or better securities. (the 25% dollar limitation does not apply to short to intermediate-term funds which are restricted to U.S. Treasury and Agency securities which may be purchased without limitation) • Fund must have been in existence for at least two years with assets of at least $1 billion. • Mutual funds investing in equities shall not be purchased. • Long-term bond funds are not Authorized Investments given the potential for fluctuation of fund share price with changes in interest rates.
Money Market Funds	Unlimited investments in "high-quality money market funds" are permissible. "High-quality money market funds" is defined as a money fund that: • Is limited to investments in US Treasury and Agency securities OR: • Meets the following criteria: (i) seeks to maintain a stable share price of $1.00. (ii) invests in only "eligible securities" as defined by Rule 2a-7 of the Investment Company Act of 1940 (which among other restrictions permits only securities with remaining maturities of 397 calendar days or less.) (iii) purchases only "first-tier securities" (per Rule 2a-7) that present minimal credit risk. (iv) is a fund approved by the National Association of Insurance Commissioners (NAIC) as a permitted investment. (v) has minimum fund assets of $2 billion.
Municipal and State Obligations or Tax-Exempt Obligations	• Acceptable investments include: commercial paper, variable rate demand note or bonds, project and anticipation notes, notes, bonds, and warrants. • Credit rating within the top three ratings of a nationally recognized statistical rating organization. • Not more than 10% of total portfolio in single issuer. • Not more than 10% of outstanding debt of any single issuer
Other Permitted Investments	The following investments shall be permitted without regard to any dollar limitation noted in the remainder of the policy: **ACCOUNTS RELATED TO SERIES 2004 BONDS** • Construction Fund Investment on Series 2004A/B bonds. Gauranted Investment Contract with FSA in an initial amount of $109,959,613.55 on December 23, 2004.

- Forward delivery/forward purchase agreement on Series 2004A/B debt service reserve fund with Morgan Stanley Capital Services/Morgan Stanley & Co. dated 12/29/2004 , with stated interest rate of 3.661%.
- Forward delivery/forward purchase agreement on Series 2004A/B bond fund with JPMorgan dated 12/29/2004, with stated interest rate of 3.821%.

ACCOUNTS RELATED TO SERIES 2000 BONDS

- Any forward/delivery purchase agreement on the Series 2000ABC bond fund (comparable to the 2004AB fund noted above) and structured subsequent to the approval of this revised policy.
- Guaranteed Investment Contract with JPMorgan Chase Bank dated June 1, 2000 in an initial amount of $2,823,000 at an interest rate of 6.79203%.