

Memorandum

To: ISO Board of Governors

From: Ryan Seghesio, Vice President, Chief Financial Officer & Treasurer

Date: March 15, 2023

Re: **2022 Annual Investment Performance Report**

This memorandum does not require Board action.

EXECUTIVE SUMMARY

The investment policy of the California Independent System Operator Corporation requires the Chief Financial Officer to submit an annual investment report to the Board of Governors. This report provides the Board with unaudited information about the 2022 investment performance of the various unrestricted and restricted fund balances held by the ISO.

- As of December 31, 2022, all portfolios were in compliance with ISO investment policies.
- During 2022, the ISO's unrestricted portfolio declined -5.9% to a balance of \$266.1 million at the end of the year. The negative investment performance was the result of the worst performing bond market ever over a calendar year. Bond prices declined rapidly as the Federal Open Market Committee raised interest rates at an unprecedented rate to curb inflation. All bond related benchmarks were negative for the year. Total return information on other portfolios will be described in the report.
- Interest rates increased across the yield curve in 2022 as the Federal Open Market Committee increased rates to curb inflation (see table below). In general, this created a difficult environment for fixed income portfolios.

U.S. Treasury Bond	Yield as of 12/31/21	Yield as of 12/31/22
2-year	0.73%	4.41%
3-year	0.97%	4.22%
5-year	1.26%	3.99%
10-year	1.52%	3.88%

DISCUSSION AND ANALYSIS

Unrestricted portfolio

The market value of the ISO's unrestricted portfolio as of December 31, 2022 was \$266.1 million. This portfolio contains the funds received by the ISO for grid management charges and other revenue collections. These funds are used for the general corporate purposes of the ISO including: operations and maintenance expenses, debt service, capital expenditures and various reserves. The portfolio's total return for 2022 was negative 5.9%. A small portion of the portfolio, totaling \$2.9 million at the end of the year, has been earmarked as assets related to the ISO Retiree Medical Plan and are invested under a separate investment policy.

Excluding the effects of those assets, the remaining \$263.2 million portfolio returned negative 5.8% during 2022. The unrestricted assets continue to be invested in the fixed income mutual fund strategy that was implemented in 2018. That strategy segments the cash into three categories (operating, reserve, and strategic) and utilizes fixed income mutual funds for the investment management. Balances and returns by segment as of December 31, 2022:

Unrestricted Portfolio (excluding Retiree Medical assets)	Market Value <i>(in \$ millions)</i>	2022 Total Return
Operating Cash:		
Cash & Money Market Funds	16.2	1.6%
Reserve Cash:		
Ultra-short Funds (< 1 year duration)	15.5	1.2%
Strategic Cash		
1-3 Year Duration	88.0	-1.8%
1-5 Year Duration	73.9	-6.0%
5-7 Year Duration	69.5	-13.2%
Total Portfolio:	263.2	-5.8%

The duration of the portfolio, which is similar to weighted average maturity, at the end of the year was 2.8 years. Duration can be used as a measure to assess the impact of interest rate movements during the year. In general, a 100 basis point (1.0%) change in interest rates will cause the value of a bond portfolio to move 1.0% for every year of duration. Given the nearly 350 basis point increase in Treasury yields this year in the 2-

3 year area of the curve, a portfolio with a duration of 2.8 years could be expected to decline in value by approximately 9.8%. That expected decline was offset by higher income being produced by the portfolio due to higher interest rates resulting in the negative 5.8% total return on unrestricted assets.

Retirees Medical Plan funds

The ISO sponsors the California ISO Retirees Medical Plan, a defined benefit plan, to provide post-employment health care benefits to eligible employees who retire from the ISO. Assets associated with the plan are invested under a separate investment policy approved by the Board which aligns the investment strategy of the assets with the long-term nature of the liabilities. The designated assets are held in two accounts: 1) a trust account which was established to hold the assets associated with the liabilities of current retirees and fully eligible employees; and 2) a custody account which holds designated assets from the ISOs unrestricted funds relating to the balance of the liabilities.

As of December 31, 2022, the market value of the trust was \$17.8 million and the custody account was \$2.9 million. The combined portfolios declined 16.0% for the year as the equity markets also performed poorly. The target asset allocation of the portfolio is tied to the “Moderate Portfolio” strategy in the ISO’s 401(k) plan, which is 55% growth, 35% stability, and 10% real return.

In 2022, the Board approved a temporary waiver of the portfolio sizing requirements of the custody account due to the small size of the portfolio and the potential negative impacts of short-term trading of these long-term assets. It is anticipated that the waiver will continue in 2023 given the underperformance of the markets and any change in that strategy after receipt of the annual actuary report will be communicated to the Board.

Generation interconnection project related funds

The ISO maintains a pool of funds related to generation interconnection project deposits. As of December 31, 2022, the market value of these funds was \$172.0 million. These funds are invested in government money market funds and FDIC-insured instruments. The total return on these funds was 1.5%.

Market funds

The ISO manages restricted funds for market participants consisting of amounts which are to be remitted back to market participants or others on their behalf. The majority of these funds are the required collateral deposits that the ISO collects as part of its credit policy to reduce the impact of defaults. As of December 31, 2022, the market value of these funds was \$956.7 million. Due to their liquid nature, these funds are invested in government money market funds which returned 1.5% for the year.

As required by the investment policy, a detailed list of all investments across the portfolios described above can be found in Attachment 1.