

Memorandum

To: ISO Board of Governors

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

Date: March 18, 2020

Re: 2019 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 2019 investment performance of the various unrestricted and restricted fund balances held by the ISO.

Note: While not addressed in the performance numbers contained in this report, the extreme market volatility that we have experienced in early 2020 related to the coronavirus outbreak has had minimal impact to ISO assets. The volatility has tended to benefit investment grade fixed income assets, which the vast majority of ISO assets are invested.

- As of December 31, 2019, all portfolios were in compliance with ISO investment policies.
- During 2019, the ISO achieved a total return of 5.3% on the unrestricted cash and investment balance, which was \$221.1 million at the end of the year. This compares very favorably to the custom benchmark we track performance against which returned 3.8%. Although the unrestricted portfolio benefited from a small portion of the funds (\$12.8 million) invested in long-term assets outside of the scope of the benchmark. Total return information on other portfolios will be described in the report.
- Interest rates declined across the yield curve in 2019 as the Federal Open Market Committee decreased overnight interest rates three separate times during the year. Long-term rates also fell as trade concerns muted the global economy.

The following table shows the level of U.S. Treasury interest rates at the end of the previous two years:

| U.S. Treasury Bond | Yield as of 12/31/18 | Yield as of 12/31/19 |
|---------------------------|-----------------------------|-----------------------------|
| 2-year | 2.48% | 1.58% |
| 3-year | 2.46% | 1.62% |
| 5-year | 2.51% | 1.69% |
| 10-year | 2.69% | 1.92% |

A brief summary of key portfolio characteristics follows, and a detailed list of investments is in Attachment 1.

DISCUSSION AND ANALYSIS

Unrestricted portfolio

The market value of the ISO's unrestricted portfolio as of December 31, 2019 was \$221.1 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 2019 was 5.28%. The total return was enhanced by the long-term assets associated with the Retirees Medical Plan. These assets, totaling \$12.8 million at the end of the year, have 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 \$208.3 million portfolio returned 4.54% during 2019. The elevated total return performance is the result of the new investment strategy that has been implemented over the past 18 months. That strategy segmented the cash into three categories (operating, reserve, and strategic) and utilized more fixed income mutual funds for the investment management.

Balances by segment as of December 31, 2019:

| Unrestricted Portfolio (excluding Retiree Medical assets) | Market Value <i>(in \$ millions)</i> |
|--|--|
| Operating Cash: | |
| Cash & Money Market Funds | 6.1 |
| Reserve Cash: | |
| Ultra-short Funds (< 1 year duration) | 10.6 |
| Strategic Cash | |
| 1-3 Year Duration | 113.6 |
| 1-5 Year Duration | 25.2 |
| 5-7 Year Duration | 52.9 |
| Total Portfolio: | 208.3 |

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, 2019, the market value of the trust was \$16.9 million and the custody account was \$12.8 million. The combined portfolios returned 17.2% for the year as both equity and fixed income markets experienced positive returns. The target asset allocation remains tied to the “Moderate Portfolio” strategy in the ISO’s 401(k) plan, which is 55% growth, 35% stability, and 10% real return.

Generation interconnection project related funds

The ISO maintains a pool of funds related to generation interconnection project deposits. As of December 31, 2019, the market value of these funds was \$85.1 million. These funds are invested in government money market funds and FDIC-insured instruments. The total return on these funds was 1.74%.

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, 2019, the market value of these funds was \$327.4 million. Due to their liquid nature, these funds are invested in government money market funds and returned 1.63% 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.