

**California Independent System Operator  
Retirees' Medical Plan**

**INVESTMENT POLICY STATEMENT**

**August 2013**

**California Independent System Operator  
Retiree Medical Plan  
INVESTMENT POLICY STATEMENT**

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**I. INTRODUCTION**

**A) Purpose of Investment Policy Statement**

The purpose of this Investment Policy Statement is to record the investment objectives and investment policies for the California Independent System Operator Retiree Medical Plan (the "Plan"). It is intended to assist the California Independent System Operator Corporation Employee Pension Benefits Committee (the "Committee") in meeting its fiduciary obligations under the Employee Retirement Income Security Act of 1974 ("ERISA") by effectively constructing, supervising, and evaluating the investment program established for the Plan by:

- 1) Making a clear distinction between the responsibilities of the Committee, the investment fund managers, the Plan participants and beneficiaries, and other Plan service providers,
- 2) Establishing suitable asset classes, investment styles, and a strategic asset allocation for the Plan,
- 3) Seeking to ensure prudent diversification of Plan assets to minimize the risk of large losses, and
- 4) Establishing a framework for selecting, monitoring, and evaluating the Plan's investment funds.

In accordance with fiduciary responsibility assigned under ERISA, investment decisions made by the Committee will be made for the sole interest of the participants and beneficiaries of the Plan.

This Investment Policy Statement is an outline of the Committee's general investment policies and is intended to supersede any earlier Investment Policy Statement(s) and objectives effective with the date this statement is executed. The Investment Policy Statement is expected to be reviewed at least every two years and revised as necessary to ensure it adequately reflects changes related to the Plan.

The intent of this Investment Policy Statement is to provide a meaningful framework for the investment selections of the Plan. The policies and practices outlined in this Investment Policy Statement will not be overly restrictive given changing economic, business, and capital market conditions. An additional intent of this Investment Policy Statement is to be sufficiently specific to be meaningful, but flexible enough to be practical. It is understood that there can be no guarantees about the attainment of the goals or investment objectives outlined here.

**B) Plan Objective**

The Plan was established to provide eligible employees with a qualified health reimbursement arrangement. The Plan will be funded by employer contributions and the investment of assets within the Plan will be directed by the Committee.

**C) Investment Objectives**

The policies contained in this document, in concert with the Plan's funding policy, and employer contributions to the Plan, are intended to assist the Committee in meeting the following objectives:

- 1) To provide sufficient assets to meet benefit obligations as they come due,
- 2) To diversify across and within capital markets, and

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- 3) To maximize the Plan's annual and cumulative total rate of return subject to prudent risk taking.

**D) Plan document and Summary Plan Description**

The Plan document and Summary Plan Description for the Plan are the governing Plan documents and contain the specific Plan provisions and requirements for determining eligibility to make and/or receive benefits under the Plan provisions.

**II. STATEMENT OF RESPONSIBILITIES**

**A) Committee**

The Board of Governors has delegated responsibility of appointing Committee members to the President and CEO of the California Independent System Operator. The responsibility as the Named Fiduciary for management of Plan assets has been delegated to the Committee. ERISA outlines those duties under ERISA Section 404(a).

It is the intent of the Committee to fulfill its fiduciary responsibilities in compliance with ERISA. ERISA requires that a fiduciary discharge its duties, with respect to the Plan, solely in the interest of the participants and beneficiaries. The Committee members are to perform their duties with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

In fulfilling their fiduciary duty, or duties, the Committee members are responsible for:

- 1) Establishing and maintaining the Investment Policy Statement and Plan objectives.
- 2) Managing and controlling the assets designated to the Plan.
- 3) Determining the strategic asset allocation of the assets of the Plan.
- 4) Selecting, monitoring, and evaluating all investment funds in accordance with guidelines and benchmarks established within this document and in compliance with ERISA.
- 5) Disbursing monies from the assets on direction of the insurance company or other entity designated by the Company that is responsible for the payment of benefits.
- 6) Directing the CFO, or his designee, to execute portfolio trades as appropriate.

**B) Investment Funds**

The Plan primarily uses mutual funds as Plan investment vehicles. The Committee may select separately managed accounts, collective trusts, commingled pooled funds, and any other funding vehicles it deems appropriate for use by the Plan. These various funding vehicles and approaches are collectively and interchangeably referred to as investment funds, investment managers, investment fund managers, investment products or registered investment advisors within this policy.

- 1) General Responsibilities. All registered investment advisors managing assets of the Plan shall maintain the assets of the Plan in compliance with all applicable laws, including

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ERISA and its fiduciary standards. Responsibilities include, but are not limited to, the following:

- a) In general, the primary responsibility of each investment fund is to invest assets in accordance with its prospectus or purchase agreement and declaration of trust.
  - b) All mutual funds shall be registered Investment Companies as defined under the Investment Company Act of 1940 (the "Act"). The Investment Companies need not be classified as "diversified" Investment Companies as defined in the Act.
- 2) Information Provided to the Committee. The Committee may from time to time request the investment fund manager(s) or their representatives to meet with them to discuss the following topics, including but not limited to:
- a) The investment manager's views concerning the economy and the securities markets, with focus on the likely impact of the investment fund's strategies on portfolio performance.
  - b) The effects of any changes to the investment fund's organization, investment philosophy, financial condition, or professional staff.
- 3) Specific Duties. The specific duties and responsibilities of each investment fund are as follows:
- a) Managing the Plan's assets under their supervision in accordance with their published guidelines or prospectus.
  - b) Exercising full investment discretion in regards to buying, managing, and selling assets held in the portfolio.

**C) Investment Consultant**

The primary responsibility of the investment consultant is to inform and advise the Committee on various investment-related issues with respect to the oversight and potential enhancements of the Plan. Such services include:

- 1) Assisting the Committee with developing an appropriate asset allocation
- 2) Providing timely and accurate reports evaluating the return, risk and characteristics of each of the investment funds compared to appropriate indexes and/or peer group universes.
- 3) Apprising the Committee of changes with regard to the Plan's investment funds in a reasonable time frame given the significance of the information.
- 4) Conducting an investment fund review at the request of the Committee when, for example, noteworthy changes or significant under-performance occurs.
- 5) Assisting the Committee in the search and replacement of existing investment funds as needed.
- 6) Consulting with the Committee regarding plan design/compliance issues as needed.

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The investment consultant's role is to provide information and advice to the Committee. The investment consultant has no discretionary control or authority over the Plan and its assets. However, the investment consultant has a limited fiduciary role with respect to the advice given to the Committee, as outlined in ERISA Section 3(21)(A) and (ii) "Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent ... (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, ...".

**D) Trustee / Custodian**

The trustee is a non-discretionary trustee that takes direction from the Committee. The trustee has fiduciary responsibility with respect to the Plan assets under its control. The trustee is charged with the following responsibilities:

- 1) Carrying out appropriate instructions from the Committee
- 2) Holding and accounting for assets; and
- 3) Making benefit payments to Trust participants as directed.

**III. COMMITTEE PROCESS**

**A) Meeting Frequency**

The Committee generally meets quarterly to review the performance of the investment funds. The Committee reviews the Investment Policy and investment funds offered in the Plan at least every two years, or as needed.

**B) Investment Fund Selection**

Searches for investment funds within an asset class will be among funds that have demonstrated a successful track record. In addition it is expected that the manager would have above median performance for a trailing period of at least three years or longer. In addition, the Committee will generally select funds that are relatively well diversified.

In selecting an investment fund, a due diligence process is followed that analyzes the investment fund in terms of certain attributes, including but not limited to:

- 1) Investment performance track record and consistency of returns achieved with risks taken.
- 2) Alignment of investment fund philosophy, process and style with Plan investment objectives.
- 3) Size and experience of professional staff.
- 4) Tenure of investment management team.
- 5) Competitiveness of investment management fees.

**C) Investment Fund Performance Evaluation**

The Committee will review the performance of investment funds generally quarterly to determine if they are achieving the established benchmarks (peer group and index performance comparisons). Performance benchmarks will be established for each investment fund and/or asset class at the time the class is included. The performance review may include

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measuring the investment funds' investment performance against stated benchmarks and peer groups as well as monitoring risk measures. The following general criteria may be used in the evaluation:

1) Quantitative Measures:

- a) Active Investment Strategies. Investment funds employing active management are expected to have investment return rankings above the median (50<sup>th</sup> percentile) of the appropriate peer group for both the trailing five year time period. Representative benchmarks and peer groups are outlined in Appendix A.
- b) Passive Investment Strategies. Passive investment funds are expected to track the investment return of the index strategy that the investment fund is designed to replicate, less management fees, with marginal tracking error. It is also expected that the risk of each investment fund, as defined by standard deviation of returns, be commensurate with the appropriate market index. The benchmarks are outlined in Appendix A.

2) Qualitative Measures. The investment funds may also be monitored on an ongoing basis for other material changes that the Committee may determine are of importance to the decision to retain an investment fund, such as personnel departures, organizational changes, or alterations in investment style, philosophy, or strategy, and adherence to stated guidelines to the extent such changes may be known.

3) Time Periods. The Committee acknowledges that fluctuating rates of return characterize the securities markets, particularly during short-term time periods. Recognizing that short-term fluctuations may cause variations in an investment fund's performance, the Committee intends to employ investment funds with long-term investment strategies and will evaluate investment fund performance from a long-term perspective. Performance over market cycles of five or more years may be weighted more heavily than performance over shorter time periods, such as one year or less.

**D) Investment Fund Termination and Watch Status**

All investment funds are expected to perform according to their prescribed benchmarks under this Investment Policy Statement. The Committee recognizes the long-term nature of investing assets of the retiree medical plan and the variability of market returns. Periodic underperformance in any of the criteria outlined in this policy will not necessitate the termination of an investment fund. Underperformance may provoke consideration by the Committee of the factors causing underperformance and possible courses of action that the Committee may take.

The Committee may place an actively managed investment fund on watch if, for two consecutive quarters, the investment fund's performance is below the 75<sup>th</sup> percentile of its peer group over both the three- and five-year trailing periods.

Other factors that may contribute to placing a fund on watch are:

- 1) Significant change in the risk profile of the investment fund as measured by the standard deviation of returns.

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- 2) Significant increase in management fees or expense ratios.
- 3) Turnover in the management team of the investment fund.
- 4) Significant increase or decrease of assets under management.
- 5) Deviation from style for which the investment fund was selected.
- 6) Significant organizational change, changes in ownership, mergers, etc.
- 7) Other factors that the Committee may determine are important for consideration.

An investment fund that is on watch will undergo a greater level of review and analysis. An investment fund may remain on watch status until the Committee decides to take further action. Committee actions include, but are not limited to the following:

- 1) Remove the investment fund from watch status,
- 2) Continue the investment fund in watch status, or
- 3) Remove the investment fund and reallocate fund assets to an alternate fund or replacement fund by Committee direction.

The Committee will endeavor to use its best judgment and information available to act in a prudent manner on behalf of the Plan and its participants. The Committee reserves the right to terminate any investment fund at any time for any reason when it determines such termination is in the best interests of the Plan and its participants and beneficiaries.

**E) Quorum and Manner of Acting**

A quorum shall be a simple majority of members. A quorum must be present for the Committee to take action. Decisions for any action taken by the Committee will be by majority vote of the members of such quorum. Members can participate in meetings in person, videoconference, phone, or other electronic means.

**F) Action Without a Meeting**

Any action required or permitted to be taken at any meeting of the Committee may be taken without a meeting if the written consent to such action by a majority of all Committee members is provided. Such written consent may be provided in one document or in multiple copies of the same document, including electronic means such as email.

**IV. ASSET CLASSES**

The Committee may consider the following asset classes for possible inclusion in the Plan as investment choices:

- **Capital Preservation Funds**
- **Fixed Income Funds**
- **Inflation Oriented Funds**
- **Domestic Equity Funds**
- **International Equity Funds**



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- **Index Funds**

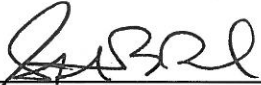
- **Real Estate Funds**

- **Other Asset Classes**

The Committee may also consider other asset classes or strategies as it deems appropriate.

**V. ADOPTION AND SIGNATURES**

This Investment Policy Statement is adopted by the Committee and effective on this 8th day of August, 2013.



\_\_\_\_\_  
Stephen Berberich



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Eric Schmitt



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Ryan Seghesio



\_\_\_\_\_  
Rebecca Regan

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**VI. APPENDICES**

Per the California Independent System Operator Corporation's Board of Governors approval at their March 20-21, 2013 meeting, the designated assets associated with the present value of the Plan's liabilities, defined as the Accumulated Postretirement Benefit Obligation (APBO), will be invested in a manner similar to the Moderate Portfolio in the Pre-Mixed Portfolio Allocations defined in the ISO's Retirement Savings Benefits Plan (the 401(k)). The APBO is calculated annually by a third-party actuary and is contained within the ISO's audited financial statements. The designated assets are contained within two accounts at the Trustee/Custodian: 1) the Voluntary Employees Beneficiary Association (VEBA) Trust, which holds the assets associated with the liabilities of current retirees and employees who have reached the eligibility requirements of the Plan, and 2) the custody account, which holds the balance of the assets associated with the APBO but not yet transferred to the Trust. The ISO will annually adjust the assets contained in these accounts per the calculated APBO and the Trust's funding policy.

**A) Appendix A – Strategic Asset Allocation**

| <b>Asset Class</b>              | <b>Strategic Asset Allocation</b> | <b>Minimum</b> | <b>Maximum</b> | <b>Benchmark Index</b> |
|---------------------------------|-----------------------------------|----------------|----------------|------------------------|
| <b><u>Total Stability</u></b>   | <b>35%</b>                        | 25%            | 45%            | BC Aggregate Index     |
| <b><u>Total Real Return</u></b> | <b>10%</b>                        | 5%             | 15%            | BC US TIPs             |
| <b><u>Total Growth</u></b>      | <b>55%</b>                        | 45%            | 65%            | MSCI ACWI              |
| <b>Domestic Equity</b>          | 27%                               | 22%            | 32%            | S&P 500 Index          |
| <b>International Equity</b>     | 28%                               | 23%            | 33%            | MSCI ACWI Ex-US        |
| <b><u>Total Portfolio</u></b>   | <b><u>100%</u></b>                |                |                |                        |

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**B) Appendix B – Policy Index**

| POLICY INDEX               | %   | Benchmark             |
|----------------------------|-----|-----------------------|
| Total Stability            | 35% | BC Aggregate Index    |
| Total Real Return          | 10% | BC US TIPS            |
| Total Domestic Equity      | 27% | S&P 500 Index         |
| Total International Equity | 28% | MSCI ACWI Ex-US Index |

**Rebalancing**

Under normal circumstances, deviations of 5% or less from the target policy will be permitted without action. Deviations of between 5% and 10% shall normally result in adjustments in cash flow allocations of sufficient magnitude to result in attainment of the target allocation within a one-year period, although the Trustees could decide to reallocate assets among Investment Managers over a shorter time period. For deviations of more than 10% the Trustees will generally take action to reallocate assets among Investment Managers. Unusual circumstances, including periods of great uncertainty, and substantial anticipated additions or reductions to or from Plan assets will be addressed prior to allowing any substantial deviation from the asset allocation specified in this Investment Policy.

**C) Appendix C – Description of Relevant Benchmarks and Peer Groups**

| Asset Class / Fund        | Peer Group                           | Index                     |
|---------------------------|--------------------------------------|---------------------------|
| Money Market              | Money Market Median Return           | 90-day T-bills            |
| Inflation Protected Bonds | Inflation Protected Bond MF Universe | BC US TIPS                |
| Low Duration Bond         | Low Duration Bond MF Universe        | BC 1-3 Year Govt. Credit  |
| Intermediate Term Bond    | Intermediate Bond MF Universe        | BC Aggregate Bond         |
| Large Cap Blend           | Large Blend MF Universe              | S&P 500 Index             |
| Large Cap Growth          | Large Cap Growth MF Universe         | Russell 1000 Growth Index |

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| Asset Class / Fund       | Peer Group                          | Index                        |
|--------------------------|-------------------------------------|------------------------------|
| Large Cap Value          | Large Cap Value MF Universe         | Russell 1000 Value Index     |
| Mid Cap Blend            | Mid Cap Blend MF Universe           | Russell Mid Cap Index        |
| Mid Cap Growth           | Mid Cap Growth MF Universe          | Russell Mid Cap Growth Index |
| Mid Cap Value            | Mid Cap Value MF Universe           | Russell Mid Value Index      |
| Small Cap Blend          | Small Cap Blend MF Universe         | Russell Small Cap Index      |
| Small Cap Growth         | Small Cap Growth MF Universe        | Russell Small Growth Index   |
| Small Cap Value          | Small Cap Value MF Universe         | Russell Small Value Index    |
| Small/Mid Index          | Mid Cap MF Universe                 | Russell 2500 Index           |
| Foreign Large Cap Blend  | Foreign Large Cap Blend MF Universe | MSCI ACWI ex US              |
| Foreign Large Cap Growth | Foreign Large Growth MF Universe    | MSCI ACWI ex-US Growth       |
| Foreign Large Cap Value  | Foreign Large Value MF Universe     | MSCI ACWI ex-US Value        |