

Memorandum

To: ISO Board of Governors
From: Ryan Seghesio, Vice President, Chief Financial Officer & Treasurer
Date: May 4, 2022
Re: **Decision on Retiree Medical Investment Policy Exception**

This memorandum requires ISO Board of Governors action.

EXECUTIVE SUMMARY

Since 2013, the ISO has invested the assets of the Retiree Medical Plan under an investment policy that differs from the investment policy covering the majority of corporate assets. The Retiree Medical Plan Investment Policy allows for a balanced portfolio of longer-term fixed income and equity assets to match the long-term liabilities of the Retiree Medical Plan. The portfolio is held in two accounts:

1. The Voluntary Employees Beneficiary Association (VEBA) Trust account, which holds the liabilities of current retirees and active employees who have reached the eligibility requirements of the Plan, and
2. The Plan's custody account, which holds unrestricted assets of the ISO equaling the net liabilities of all active employees who have not reached the eligibility requirements of the Plan.

As stated in the policy, the size of the portfolios are adjusted annually based upon the liabilities calculated by a third-party actuary. Due to various Plan design changes over the last nine years and above average investment returns, the current policy language would require the closure of the custody account since the net liabilities have declined to less than zero.

Given that liabilities, as well as investment returns, associated with the Retiree Medical Plan are volatile, Management recommends that the Board approve a temporary exception to the portfolio sizing language in the policy. The exception will allow the ISO to hold the investments in the custody account (\$3.5 million as of December 31, 2021) versus a complete liquidation in 2022 and potential repurchase in a future year. Management will update the Board on the status of the exception annually in the Annual Investment Report which is submitted to the Board in March of each year.

Management proposes the following motion:

Moved, that the ISO Board of Governors approves the Retiree Medical Plan investment policy exception as described in the memorandum dated May 4, 2022.

DISCUSSION AND ANALYSIS

Several Plan design changes, above average investment returns, and other favorable assumptions used by a third-party actuary to determine the liabilities of the Plan has caused the total and net liabilities of the Plan to decline. A summary of the liabilities over the last five years is in the table below:

<i>(IN \$ MILLIONS)</i>	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021
Total Liabilities	24.9	25.5	22.5	22.3	21.1
Less: Assets in VEBA Trust	(11.1)	(10.4)	(17.0)	(19.3)	(21.2)
Net Liabilities (= assets in custody account)	13.8	15.2	5.5	3.0	(0.1)

The Plan's investment policy designates that the assets will be held in two portfolios and the size of the portfolios will be adjusted annually based upon the actuarial report:

1. The Voluntary Employees Beneficiary Association (VEBA) Trust, which holds the assets associated with the liabilities of current retirees and active employees who have reached the eligibility requirements of the Plan. Annually, the ISO will ensure that the balance in the Trust is at least as much as the current liabilities associated with this group (not displayed in table above). If underfunded, the appropriate amount will be transferred from the custody account. Overfunded amounts remain in the Trust.
2. The custody account, which holds the assets associated with the net liabilities of all active employees who have not reached the eligibility requirements of the Plan. The net liabilities represent the liabilities presented in the ISO's financial statements. Net liability is calculated by subtracting the value of the Trust account from the total liability. Annually, the portfolio size will be adjusted to first fund any needed amounts into the Trust and second, to equal the resulting net liability.

As the table shows, the total liabilities have been declining while the value of the Trust has been increasing, resulting in a lower required amount in the custody account. At

the end of 2021, the value of the Trust now exceeds the total liabilities, which would require the ISO to liquidate the remaining \$3.5 million in the custody account per the policy sizing language. However, liabilities associated with retiree medical plans tend to be very volatile as many different assumptions are used by the actuary. Furthermore, investment returns can also be volatile on a short-term basis, as we are experiencing in 2022. This volatility could quickly reverse the net liability calculation and result in the ISO repurchasing the custody portfolio that the current policy language is requiring the ISO to liquidate.

CONCLUSION

Due to the volatility described above, Management recommends a temporary exception be approved to the policy language describing the sizing of the custody account. Management will continue to review future actuarial reports and report on the status of the exception in the Annual Investment Report that is submitted annually to the ISO Board of Governors at the March meeting. Any changes to the exception will be brought to the ISO Board of Governors for consideration.