Memorandum

To: ISO Board of Governors

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

Date: May 9, 2018

Re: **Decision on modification to Retiree Medical Plan Investment Policy**

This memorandum requires Board action.

EXECUTIVE SUMMARY

The Retiree Medical Plan Investment Policy governs the investment of assets associated with the liabilities of the ISO's Retiree Medical Plan. The current strategy, originally implemented in 2013 and modified in 2014, was designed to better align the designated long-term assets of the plan to its long-term liabilities. The policy covers two portfolios:

Trust account: A portfolio designed to represent the liabilities associated with the current retirees and the active employees who have reached the eligibility requirements of the Plan. Assets placed in this portfolio are no longer assets of the ISO and instead belong to the Trust for the benefit of those employees. The Trust is currently overfunded with a market value of $11.1 million, as of March 31, 2018, compared to relative liabilities of $10.7 million.

Custody account: A portfolio carved out of the ISO's unrestricted assets designed to represent the liabilities for all active employees who have not reached the eligibility requirements of the Plan. These liabilities represent the net liabilities on the ISO's balance sheet and the expense for funding these liabilities is part of the ISO's annual revenue requirement. The assets in the custody account are currently $9.6 million, as of March 31, 2018.

In June 2015, the Governmental Accounting Standards Board (GASB) introduced Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefit Plans Other Than Pensions*, to improve the accounting and financial reporting of financial statement liabilities associated with other postemployment benefit plans. The ISO adopted these standards with the release of the financial statements ending December 31, 2017.

The Retiree Medical Plan Investment Policy contains language setting the size of the two portfolios based upon defined terms from the annual actuarial report the ISO receives, which is regulated by the GASB standards. The calculation and definition of those terms have changed with the adoption of the new accounting standards. Therefore, our existing policy language needs to change to reflect the new standards. The proposed policy changes will reflect that the Trust account will continue to be maintained at a fully or overfunded status and the custody account will be maintained at a level consistent with the Net OPEB Liability amount from the actuarial report, which represents the net liabilities on the ISO's financial statements.

The impact of the policy change this year will be an approximate $4.2 million deposit into the custody account increasing its value to $13.8 million, which corresponds to the liabilities in the recently released 2017 financial statements.

Management recommends modifying the language in the Retiree Medical Plan Investment Policy as outlined below.

> ***Moved, that the ISO Board of Governors approves the modifications to the ISO Retiree Medical Plan Investment Policy as described in the memorandum dated May 9, 2018.***

POLICY LANGUAGE

The first paragraph of Section VI-Appendices, of the investment policy will be modified as shown below:

New language: Per the California Independent System Operator Corporation's Board of Governors approval at their May 16-17, 2018 meeting, the designated assets associated with the present value of the Plan's liabilities 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 liabilities are calculated annually by a third-party actuary and the net liabilities are 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 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. 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 are defined as the Net OPEB Liability and represent the liabilities presented in the ISO's financial statements. Net OPEB Liability is calculated by subtracting the value of the Trust

account (Fiduciary Net Position) from the Total OPEB Liability. Annually, the portfolio size will be adjusted to first fund any needed amounts into the Trust and second, to equal the resulting Net OPEB Liability.

Old language: 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 Net Other Post-Employment Benefits (NET OPEB), 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 NET OPEB 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 NET OPEB but not yet transferred to the Trust. The ISO will annually adjust the assets contained in these accounts per the calculated NET OPEB and the Trust's funding policy.