California Independent
System Operator

Memorandum

To: ISO Board of Governors

From: Phil Leiber, CFO and Treasurer

Date: December 8, 2008

Re: ***Decision on Investment Policy***

This memorandum requires Board action.

EXECUTIVE SUMMARY

This memorandum outlines proposed enhancements to the California Independent System Operator Corporation (the ISO) investment policy that was last revised in 2005. The proposed changes include:

- General revisions
- Enhancements to controls and safeguards
- Changes to authorized and prohibited investments

The ISO's current investment policy prioritizes safety of principal, liquidity, and return, and the proposed enhancements will provide further assurance that these priorities are achieved.

Motion:

Moved, that the ISO Board of Governors approves the changes to the ISO's investment policy, as detailed in the memorandum dated December 8, 2008.

BACKGROUND AND PROCESS

It is prudent and a "best practice" for an organization to periodically review their investment policy to ensure an alignment of expectations regarding risk tolerance and to ensure appropriate controls are in place. The CFO/Treasurer established this as a 2008 goal earlier this year. Because of the recent developments in the financial markets and the fact that other entities have been subjected to very substantial losses on what were believed to be reasonably safe securities (including California public entities such as the County of San Mateo which recently lost $150 million in the Lehman Brothers collapse), a review of the ISO's investment policy is particularly timely.

To ensure that the ISO investment policy includes appropriate provisions to protect ISO interests, Management, with the assistance of a retained independent investment advisor, Bridgebay Financial, Inc., have concluded a review of the investment policy last amended in June 2005 (see original policy attached as **Attachment 1** and the revised policy attached as **Attachment 2**). Changes to authorized and prohibited investments are also summarized in this memo and detailed in comparatives table in the **Appendix I and II.**

The overall policy remains conservative and Management proposes certain enhancements to mitigate risks. The significant changes to the policy are summarized in the sections below.

GENERAL REVISIONS

Formatting and References:

- The policy has been recast into the standard ISO policy form.
- Throughout the revised policy document "the ISO" replaces "CAISO." In addition, "Internal Investment Manager" replaces "Investment Director" in order to reflect the ISO's current organizational structure.
- The "Scope" section of the document has been streamlined to reflect the detailed provisions of each fund type separately within the appendices of the policy as follows:

  Appendix A- Operating Funds/Operating & Capital Reserve Funds
  Appendix B- Bond Proceed Funds
  Appendix C- Funds held by the ISO on behalf of the ISO Market or specific market participants.

ENHANCEMENTS TO CONTROLS AND SAFEGUARDS

The following changes ensure appropriate oversight of the investment policy and holdings, and address other general controls and risk mitigation measures.

1. *Policy Review:*
   Management proposes to add this section to include an annual investment policy review by the Corporate Management Committee (CMC), consisting of the President, General Counsel, VP Corporate Services, CFO/Treasurer, and Director of Organizational Effectiveness, and a review not less than every three years by the ISO Board of Governors. This will ensure sufficiency and appropriateness of the policy in the future.

2. *Internal Controls:*
   Management proposes to revise this section to clarify the segregation of duties regarding initiating, executing, confirming and settling transactions, controlling accounts and posting journal entries. This section also includes compliance guidelines for the Internal Investment Manager purchasing a non-cash or mutual fund investment.

3. *Reporting:*
   Management proposes to revise this section to provide for ongoing internal investment portfolio reporting to the CMC to ensure appropriate monitoring of portfolio holdings and investment

trends. Annual Board reporting requirements continue unchanged.

4. *External Investment Managers:*
While Management does not propose to outsource investment portfolio management at this time, we do propose to add this section defining appropriate criteria for the selection and use of an External Investment Manager, should such services be required in the future.

5. *Safekeeping:*
Management proposes to revise this section to require the use of a third party custodian for most corporate investments. A third party custodian provides improved protection for ISO securities in the event of bankruptcy of the security safekeeper. If securities are held at a broker/dealer, in contrast to custody with an independent custodian, ISO securities could become commingled with the broker/dealer's assets in the case of bankruptcy. The process to reclaim securities could be complex and protracted.   Custody is a stronger protection for ISO investments because the securities are segregated and would be returned promptly. Upon adoption of this policy change, the ISO would engage the services of an appropriate custodian in accordance with the stated custodian criteria.

6. *Diversification:*
Management proposes to add a separate section to list the maximum allowable percentages of the various types of authorized investments within the portfolio.

7. *Portfolio Risk Management*:
Management proposes to revise this section to reference two additional safeguards for minimizing investment-related risk:

    a. Credit Risk-Moody's KMV expected default frequency indicator; and
    b. Counter-party risk-FINRA Broker dealers.

8. *Third Party Portfolio Review*:
Management proposes to add this section requiring periodic investment portfolio reviews by a third party investment professional, to help the ISO identify and respond to changing market conditions or evolving risks.

9. *Exceptions*:
Management proposes to revise this section to define a course of action for unintended and/or unauthorized exceptions (i.e. more than 5% of portfolio percentage limits) to the portfolio, as stated within the "Diversification" section of the policy.   The revision enables prompt remedy to exceptions using an agreed course of policy action.

AUTHORIZED AND PROHIBITED INVESTMENTS

The core of the investment policy is what specific investments are permitted and prohibited.

1. *Authorized investments:*
   Management proposes to revise the list of authorized investments to provide more up-to-date definitions and/or restrictions on currently authorized investment categories. The changes to the current list of authorized investments are shown in **Appendix I**. Notable changes include:

   - Eliminating asset backed securities as a permissible investment due to their complex nature and risk potential

   - Distinguishing between federal agency securities, backed by the full faith and credit of the US Government, versus government-sponsored enterprises

   - Providing further clarifications and restrictions on other investments, including repurchase agreements, fixed income mutual funds

   - Revisions to the definition of acceptable money market funds

2. *Effective maturities:*
   Management proposes to add a separate section limiting the effective maturity of an individual investment to a maximum of five years. This does not change the previous policy, in which the limit was included in the discussion of individual permissible investments.

3. *Sale of securities prior to maturity:*
   Management proposes to revise this section to include the reporting of material losses greater than $100K per position to the CMC.

4. *Prohibited investments:*
   Management proposes to update the list of prohibited investments, and such changes are detailed in **Appendix II**. The list has been expanded to include securities such as collateralized trusts, short sales, auction rate securities, and structured investment vehicles, which do not meet the safety of principal, liquidity, and earnings objectives of the policy. Additional language within this section also describes generic structures that should not be permitted if named differently in the future.

   Additionally, the ISO proposes to refine a prohibition on "Securities which are ineligible to ISO employees under the ISO Code of Conduct," that essentially precludes investments in any company engaged in generation, transmission, or marketing of electricity anywhere in the United States. This prohibition appears to be unnecessarily restrictive; it is broader than currently applicable restrictions, which focus on entities that participate in the ISO's own markets.

   Accordingly, Management proposes to revise the prohibition so that it is co-extensive with applicable FERC rules. The revised policy would prohibit the ISO from purchasing:

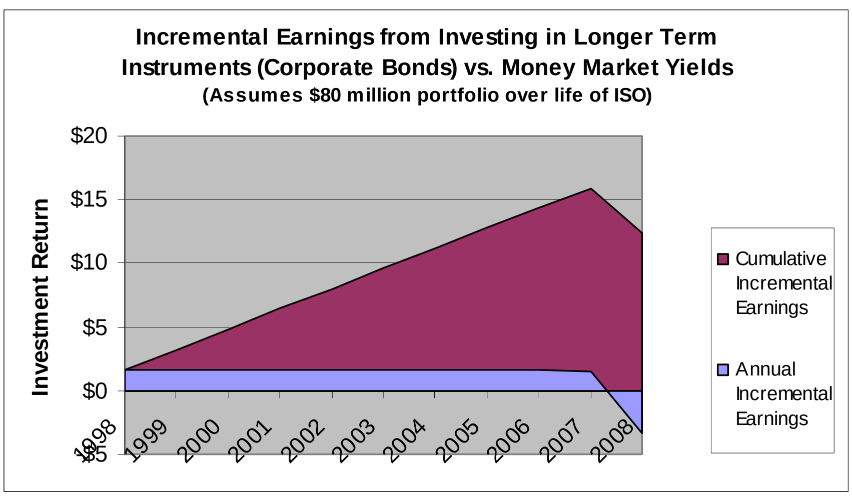
   > Securities that are contrary to FERC orders, regulations, or policy regarding ISO investments.

KEY POLICY CONSIDERATION

The existing investment policy provides that "Safety of principal" is the foremost objective, ahead of Liquidity and Earnings. We do not propose to change those objectives in the revised policy. A key policy question for Board consideration is whether investments in Corporate Bonds, even with the "above investment grade" ratings of A-/A3 or better (as the policy specifies), are consistent with these investment objectives. Our investment results in the past year (unarguably extraordinary times) have demonstrated that price declines on corporate bonds are possible, even for bonds that are "highly rated" at the time of purchase. The ISO's current bond portfolio has unrealized losses of about $5 million (against the total bond portfolio of about $80 million and total investment holdings of about $250 million). Of course this has occurred over the last year that has seen the occurrence of a variety of "unprecedented" financial stresses.

Our recommendation is to maintain the ability to invest in these highly rated corporate bonds, because despite the potential risk of loss of principal, omitting this choice from our investment alternatives comes at a significant cost. Corporate bonds provide the opportunity to earn a fixed rate of return over a specified period that can significantly exceed the return on a money market fund, where returns fluctuate. Rates on money market funds during the last recession and in the current recession dropped below 1%, so there is a significant opportunity cost of lost return if we keep all of our funds in that most liquid asset. Further, the rates on safe US Treasury notes are currently very low, and even the bonds of government sponsored enterprises such as the Federal Farm Credit Bank present some potential credit risk, and are in most cases "callable," so that if interest rates decline, the issuer of the bond returns our investment, and the ISO is required to reinvest proceeds at much lower interest rates. So, non-callable corporate bonds offer an advantage that is not readily replaced with other investment options.

Further, even with consideration of the current unrealized investment losses (most of which we expect to recover if we hold the securities to maturity), the anticipated incremental returns of longer-term debt instruments such as these corporate bonds have been worthwhile. The chart below illustrates this point.



Assumptions:

- $80 million debt portfolio since 1998 (actual holdings varied)
- ISO earns a 2% incremental return annually versus keeping the funds in a money market account

Conclusion:

- ISO is "ahead" $12 million even considering the recent $5 million unrealized investment losses.

While we would not likely increase our positions in corporate bonds at this time given the uncertain economic outlook and our current funding outlook, we do not believe that removing this investment choice is warranted at this time, and accordingly have proposed to maintain corporate bonds as an "authorized investment."

CONCLUSION

The proposed revisions are policy enhancements to mitigate risk and strengthen the conservative nature of the current policy. The changes have been reviewed and considered by an Independent Investment Advisor who is an investment policy expert. Management recommends adoption of the revised investment policy included as **Attachment 2** to this memorandum.

APPENDIX I.-AUTHORIZED INVESTMENTS

Existing Policy	Revised Policy
General Provisions (Discussed throughout the policy by security type)	**General Provisions** • *Credit Quality* All eligible securities must carry at least two credit quality ratings from either Moody's Investors Service or Standard & Poor's (S & P) or Fitch Investors Service to be eligible for purchase. In the case of split ratings, the lower of the two ratings will be considered the overall credit rating. Investments where, after acquisition by the ISO, the credit rating falls below the minimum criteria specified in this policy shall be presented to the CMC for assessment of appropriate actions, including continuing to hold the security or disposing of the security (potentially at a loss). The ISO may obtain expert advice to assess and determine a prudent course of action. A decline in a credit rating of a security below the minimums specified in this policy after acquisition by the ISO is not an exception that requires consent of the Board or Audit Committee chair as provided for in "EXCEPTIONS" section of this policy. • *Senior Securities* All eligible securities must be senior notes or senior classes of the capital structure of the issuer or senior tranche or class of the collateralized issue. Notes, tranches or classes, preferred shares and equities that are all junior to senior notes of all eligible issuers are prohibited. • *Maximum Stated Maturity* Unless otherwise noted within each of the investment categories below the maximum stated maturity is 5 years from the date of purchase by the ISO. ***Note****:* An authorized investment excludes any investment that is prohibited.

Existing Policy	Revised Policy
U.S. Treasury Bills and Notes – No Limit	**U.S. Government Obligations** Marketable debenture securities which are direct obligations of the U.S.A., issued by or guaranteed as to principal and interest by the U.S. Government and supported by the full faith and credit of the United States of America. • U.S. Treasury bills, notes and bonds are eligible. • General Services Administration • Guaranteed Title XI financing Government National Mortgage Association (GNMA) obligations are a direct government obligation but are defined as mortgage-backed securities (MBS) under this policy and accordingly not permissible for direct purchase by the ISO, (though permissible as collateral for other agreements).
Federal Agency Securities – No Limit (i.e. FMNA, FHLB, Freddie Mac, SalliMae, Farm Credit, TVA, World Bank, etc.)	**Federal Agency Securities** Senior debentures of any of the following federal agencies obligations represent the full faith and credit of the United States of America. • Farmers Home Administration (FMHA) • Export-Import Bank • Rural Economic Community Development Administration • U.S. Maritime Administration • Small Business Administration • U.S. Department of Housing & Urban Development (PHAs) • Federal Housing Administration • Federal Financing Bank
Federal Agency Securities – (Contd.)	**Government Sponsored Enterprises (GSE)** Senior debentures, direct obligations of the following government sponsored enterprises (GSE) and agencies obligations are not fully guaranteed by the full faith and credit of the United States of America issued by: • Federal National Mortgage Association (FNMA) • Federal Home Loan Bank (FHLB) • Federal Home Loan Mortgage Corporation

Existing Policy	Revised Policy
	(FHLMC) • Federal Farm Credit Bank (FFCB) • Resolution Funding Corporation (REFCORP) Eligible securities must be debentures and cannot be asset backed securities (ABS) or mortgage backed securities (MBS). Must be rated at least Aa3 by Moody's or AA- by S&P or equivalent.
Federal Agency Securities – (Contd.)	**International Agencies** Notes, bonds or debt instruments issued by international agencies including World Bank (WLDB), Asian Development Bank, Inter-American Development Bank, Agency for International Development (AID) must have a minimum long term debt rating of Aa3 by Moody's or AA- by S&P. All securities must be US dollar denominated or US dollar pay.
Commercial Paper (CP), Variable Rate Demand Obligations/Auction Rate Securities Medium Term Corporate Notes, and Asset Backed Securities For Commercial Paper (CP)/Variable Rate Demand Obligations/(VRDO)/Auction Rate Securities • U.S. Based issuers; minimum assets of $500 million • Credit rating of A1 and/or P1 or equivalent rating, or better • Not more than 10% of outstanding C.P. or VRDO or any single Issuer. Other debt of the issuer, if any, must have a credit ratting within the top three ratings (without regard to modifiers) of a nationally recognized statistical rating organization. For medium Term Corporate Notes, VRDOs/Auction Rate Securities and Asset Backed Securities: • Maximum maturity of 5 years (from date of purchase by SIO) A credit rating within the top three ratings (without regard to Modifiers) of a nationally recognized statistical rating	**Corporate Debt Obligations** All commercial paper and other short-term, unsecured promissory notes issued by domestic and foreign corporations in U.S. Commercial paper must have a short-term rating of at least A-1 (S&P), or P-1 (Moody's), or equivalent. ISO investments in particular, issuer's of commercial paper are limited to 5% of that issuer's total outstanding commercial paper. Asset-backed commercial paper (ABCP) is not permissible as an ISO investment but is a permissible holding for money market fund investments. Direct corporate obligations including but not limited to Medium-Term Notes, Deposit Notes, and Bonds. Notes and bonds must have a long-term debt rating of at least A3 by Moody's or A- by S&P or equivalent. **Floating Rate Securities** Simple or straight floating rate securities whose interest rates are linked to a well-recognized money market index such as the 3-month Treasury Bill, LIBOR, Prime Rate, 11th District Cost of Funds (COFI), Commercial Paper, or Federal Funds, with coupon resets weekly, monthly, quarterly or semi-

Existing Policy	Revised Policy
organization. For C.P., (VRDOs Auction Rate Securities, Medium Term Corporate Notes and Asset Backed Securities: • On a combined basis, CP, VRDOs, Auction Rate Securities, Medium Term Corporate Notes and Asset-Backed Securities shall not exceed 45% of the total portfolio. Allocation between the instruments may be based on funding requirements. The five year maturity limit noted above shall not apply to: • Variable rate securities with a periodic interest rate reset and a "put" feature for investors or; auction rate securities with a periodic interest rate set through an auction process. Such securities are equivalent to a liquid, short term security for the investor.	annually are eligible investments. Eligible investments must be rated at least A3 by Moody's or A- by S&P or equivalent.
Interest Bearing Demand or Time Deposits (Including Negotiable Certificates of Deposit (CDs) Issued by a national or state chartered bank, or State or Federal Savings Associate, or state licensed branch or of a foreign bank (1) with a combined capital and surplus of at least $100 million dollars, or fully insured by the Federal Deposit Insurance Corporation, or (2) secured at times by collateral security consisting of U.S. Government Obligations or Federal Agency Securities.	**Bank Obligations** Negotiable Certificates of Deposit (CD), Bank Time Deposits, Interest Bearing Demand Deposits, Checking Accounts or other non-interest bearing accounts and obligations of commercial banks with (1) a minimum deposit rating of A by Moody's or A2 by S&P or A by Fitch issued by a national or state chartered bank, or state or federal Savings Association, or state-licensed branch of a foreign bank with combined capital and surplus of at least $100 million dollars, or (2) fully insured by the Federal Deposit Insurance Corporation, or (3)secured at all times by collateral security consisting of U.S. Government Obligations or Federal Agencies.
Repurchase Agreements • Third party safekeeping • Maximum term of one year • Collateral will be valued at least at 100% and adjusted at least Quarterly • Counterparty must be a primary dealer of the Federal Reserve Bank of New York	**Tri-Party Repurchase Agreements** Repurchase agreements (repos) will be transacted only with financial institutions rated at least A3 by Moody's or A- by S&P or equivalent and counterparty must be a primary dealer of the Federal Reserve Bank of New York. All transactions must always be fully collateralized by

Existing Policy	Revised Policy
	U.S. Treasury, Federal Agency obligations, money market instruments, or corporate eligible within this Policy. Collateral must be market-priced greater than the invested amount at the time of purchase (minimum of 102%) and valued at least monthly. Collateral must be delivered and custodied at a third party custodian different from the financial institution entering into the repo transaction. Transactions are limited to 1 year maturities unless the agreement is in connection with ISO bond proceeds in which case the agreement shall not exceed the maturity the ISO bonds. Maximum 10% per financial institution.
Collateralized or uncollateralized investment agreements or other contractual arrangements such as Guaranteed Investment contracts "GICs" with banks, insurance companies, or broker dealers. • Not more than 45% of total portfolio • Credit rating of senior long term debt of such bank, broker dealer, or insurance company is rated within the top three rating categories (without regard to modifiers) by a nationally recognized statistical rating organization.	**Investment Agreements** • Investment Agreements may be collateralized or uncollateralized. Collateralized investment agreements with banks, insurance companies, or broker-dealers must be with an institution that has a senior long term debt credit rating of A2 by Moody's and A by S&P. Investment agreements may be collateralized with appropriate margin by securities permissible under this policy, GNMA and Agency-backed MBS. For uncollateralized investment agreements, with banks, insurance companies or broker-dealers must have a long-term counterparty rating of Aa2 by Moody's and AA by S&P. Note, the purchase of ABS, GNMA and Agency-backed MBS are not permissible for direct purchase by the ISO. However, those securities are eligible investments if appropriately margined as collateral for collateralized Investment Agreements or GICs or BICs, referenced below. Transactions are limited to 5 year maturities unless

Existing Policy	Revised Policy
	the agreement is in connection with ISO bond proceeds in which case the agreement shall not exceed the maturity of the relevant ISO bonds. Maximum 10% per financial institution. **Guaranteed Investment Contracts (GIC) and Bank Investment Contracts (BIC)** • Guaranteed Investment Contracts (GIC) with insurance companies must have a long-term counterparty rating of Aa2 by Moody's and AA by S&P. For a GIC provided by an insurance company it must be pari passu with insurance policy holder obligations. The GIC must have a capital facility to cover economic losses and must have contingent liquidity provided by a committed standby line of credit from a financial institution with long-term senior debt rating of Aa2 by Moody's and AA by S&P. Bank Investment Contracts (BIC) or GIC with banks must have a long-term counterparty rating of Aa2 by Moody's and AA by S&P.
Mutual Funds (Debt Only) • Not more thank 25% of total portfolio in short to intermediate term Bond funds holding investment grade or better Securities. (the 25% dollar limitation does not apply to short to intermediate term funds which may be purchased without limitation) • Fund must have been in existence for at least two years with as assets of at least $1 billion • Mutual funds investing in equities shall not be purchased • Long term bond funds are not Authorized investments given the potential for fluctuation of fund share price with changes in interest rates	**Fixed Income Mutual Fund** Investments in institutional fixed income ultra-short to intermediate-term bond funds whose net asset value (NAV) may fluctuate are permissible if the underlying securities in the fund are permissible within this policy. Funds investing in futures, options, derivatives, credit default swaps or securities prohibited by this policy are not eligible. Government or Federal Agency Funds investing in mortgage-backed securities are not permissible. Fund must have a verifiable performance history of 5 years, minimum credit quality of investments of Baa3/BBB- by Moody's or S&P investments, and average portfolio quality Aa2/AA Moody's or S&P. The ISO investments are limited to 5% of each fund's total assets. No more than 25% of ISO's total portfolio may be invested in fixed income mutual funds. Mutual funds investing in equities, preferred stocks or convertible bond securities are prohibited.

Existing Policy	Revised Policy
	Maximum average duration of a fixed income fund is 2 years given the potential for fluctuation of fund share price with changes in interest rates.
Money Market Funds Unlimited investments in "high quality money market funds" are permissible. "High quality money market funds" is defined as Money funds that: • Is limited to investment in US Treasury and; • Agency Securities, or; • Meets the following criteria: (i) seeks to maintain a stable share price of $1.00 (ii) invests in only "eligible securities" as defined by Rule 2a-7 of the Investment Company Act of 1940 (which among other restrictions Permits only securities with remaining maturities of 397 calendar days or less.) (iii) purchase only "first tier Securities" (per Rule 2a-7) that present minimal credit Risk. (iv) is a fund approved by the National Associate of Insurance Commissioners (NAIC) as a Permitted investment. (v) has minimum fund assets of $2 billion.	**Money Market Mutual Funds** Money Market Obligations are shares of an open-end investment company registered under the Investment Company Act of 1940, as amended. The investments must comply with the SEC regulations under 2a-7 and maintain a constant net asset value (NAV), offer daily liquidity, and have an average weighted maturity that does not exceed 90 days. Funds rated by S&P or Moody's or approved by the National Association of Insurance Commissioners (NAIC) as a permitted investment are preferred over unrated funds. Funds must have minimum fund assets of $5 billion. US Treasury or Government Funds are limited to no more than 25% of the fund assets in tri-party repurchase agreements. The ISO's investments are limited to 5% of each money fund's total assets. Enhanced cash, LIBOR Plus funds that are not SEC 2a-7 compliant, which underlying securities may include ABS, CMO, MBS, futures, and which net asset value (NAV) may fluctuate are not permissible as money market funds.
Municipal and State Obligations or Tax Exempt Obligations • Acceptable investments include: commercial paper, variable rate demand note or bonds, project and anticipation notes, notes, bonds, and warrants • Credit rating within the top three ratings of a nationally recognized statistical rating organization • Not more that 10% of total portfolio in single issuer • Not more than 10% of outstanding debt of any single issuer	**Municipal and State Obligations or Tax-Exempt Obligations** Direct obligations or obligations fully guaranteed by a state, territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia as well as obligations of any county or other local governmental body within the US must have a rating of SP-1 (S&P) or MIG-1 (Moody's) or equivalent for short-term securities; and notes or bonds must be rated A- (S&P) or A3 (Moody's) or equivalent rating. The ISO may not hold more than 10% of the outstanding debt of any single issuer.

Existing Policy	Revised Policy
	Municipal obligations include, but are not limited to: • Commercial paper • Short Term Notes • Bond Anticipation Notes (BANS) • Tax Anticipation Notes (TANS) • Revenue Anticipation Notes (RANS) • General Obligations (GOs) • Revenue Bonds • Project Notes • Put Bonds • Variable Rate Demand Notes (VRDNs) Credit Enhancements for Municipal Obligations Approved credit enhancements for securities include: • Bank Letter of Credit (LOC), irrevocable and unconditional, rated A-1 by S&P or P-1 by Moody's • Insurance by any monoline insurer rated a minimum of A3 by Moody's or A- by S&P or equivalent Credit enhanced securities must have an underlying issuer credit quality of A3 by Moody’s or A- by S&P Pre-Refunded Municipals Municipal obligations may be purchased, if they are collateralized or have been funded to maturity by US Treasuries or Federal Agencies held in a trust arrangement to cover all principal and interest payments.

APPENDIX II.-PROHIBITED INVESTMENTS

Existing Policy	Revised Policy
• Securities which are ineligible to the ISO Employees under the ISO code of conduct The Prohibitions exclude:	Securities that are contrary to FERC orders, regulations, or policies about ISO investments.
(a) Investments in mutual funds which may contain investments in these securities, if such securities constitute less than 5% of the net asset value of such funds.	• Investment in equity, convertible, and preferred Stock (ISO's participation in mutual/group captive insurance arrangements which may require share ownership in such entities is permissible.)
(b) Investments in money market/mutual funds managed by affiliates of market participants investments procured from affiliates of market participants otherwise permissible under this investment policy that are procur through a competitive bidding process.	• Floating rate securities with embedded options, interest rate caps, floors, collars, inverse interest rate relationships, leverage floaters, or indices not directly correlated with money market interest rate movements.
	• Stripped securities such as IO (interest-only), PO (principal-only)
	• Subordinated issues, residuals, super POs, tiered indexed bonds, and two-tiered indexed bonds
• Investments in Equity Securities	• Collateralized trusts that have embedded leverage, CBO (collateralized bond obligations), CDO (collateralized debt obligations), CLO (collateralized loan obligations
• Any security which could result in an interest accrual of zero or less if held to maturity such as: a) inverse floaters, b) range notes, c) interest only strips derived from a pool of mortgages	• The direct purchase of ABS, GNMA and Agency -backed MBS are not permissible for direct purchase by the ISO. However, those securities are eligible investments if appropriately margined as collateral for collateralized Investment Agreements, GICs or BICs.
	• Short sales, margin purchases, futures, options, and foreign currency purchases are not permitted for the investment portfolio
	• Securities with deferred interest payments, extendible maturities at issuer's option

Existing Policy	Revised Policy
	• Structured investment vehicles (SIVs) or off balance sheet funding instruments • Auction rate securities • Interest rate swap agreements on the ISO portfolio investments are not permissible. However, interest rate swap agreements on ISO debt approved by the ISO Board of Governors are permissible for ISO debt structure management only
• Investments in derivative securities (excluding interest rate swap agreements on California ISO debt approved by the ISO Governing Board)	