

Memorandum

To: ISO Board of Governors

From: Nancy Saracino, Vice President, General Counsel and Corporate Secretary

Date: September 7, 2012

Re: **Decision on Updating Corporate Policies**

This memorandum requires Board action

EXECUTIVE SUMMARY

As the ISO matures as an organization, it continues to dedicate resources and effort to building a more robust regulatory compliance program. This year, the ISO conducted a self-assessment of its internal policy development process and determined that the process required updating and improvement. As a result, the ISO established and implemented a comprehensive, formal process for developing, approving and maintaining internal policies, standards and procedures. This initiative started with an evaluation of all existing policies for uniformity and consistency with regulatory requirements and best practices. As part of this effort, the ISO established a new policy template that consists of standard sections developed to improve the ability of staff to understand policy requirements and know their roles and responsibilities, with the goal of enhancing overall compliance.

A highly dedicated cross-organizational team of subject matter experts has engaged in this effort to update and streamline the ISO's policies consistent with the new process and template. Most recently, the team reviewed and updated six of the Board-approved policies. In addition to updates to each of these policies for consistency with the new template, Management has proposed various changes to the content to reflect best practices and update for consistency with current law and the organization's needs. Management recommends that the Board approve the amendments to the policies as described in further detail below and in the log of changes enclosed as attachment 1.

Moved, that the ISO Board of Governors approves the amendments to the documents listed below, and as attached to the memorandum dated September 7, 2012:

- ***Records Availability Policy***
- ***Board Selection Policy***
- ***Compliance and Ethics Program Policy***
- ***Open Meeting Policy***
- ***Corporate Governance Principles***
- ***Investment Policy***

DISCUSSION AND ANALYSIS

1. Records Availability Policy

Originally titled as the Information Availability Policy, the ISO is proposing that the policy be renamed as the Records Availability Policy. This title is more consistent with the state statute on which it is modeled, the California Public Records Act. The Public Utilities Code requires that the ISO to provide public access to corporate records consistent with the general policies of the California Public Records Act, and requires that the ISO provide the public with “the greatest possible access, consistent with the other duties of the corporation.” Public Utilities Code section 345.5(b)(4). The statute recognizes that the currently-effective policy complies with this requirement, and also prohibits the ISO from amending the policy in a way that would make it “less consistent with the California Public Records Act.”

In addition to the title change, management recommends the following revisions to the Records Availability Policy:

- Delete the definition for the term “writing”. The definition is highly technical. It has been simplified into more easily understood terms and is now covered by the definition of a “record”;
- As some requests for records may require extensive search time, Management proposes to add a provision that allows the ISO to reach a mutual agreement with the records requestor for timing to deliver copies of requested records;
- Clarify the ISO’s process for collecting fees for copies of records, consistent with the California Public Records Act. This change reflects our evolution to be more environmentally conscious and mindful of our stakeholders wishes to receive documents electronically. The ISO primarily responds to records requests with scanned copies. While this reduces the ISO’s production of paper copies, there is effort associated with compiling scanned documents which may be charged to the requestor when it is more than nominal;
- Delete the fee amount for copies and replace with “direct cost,” consistent with the California Public Records Act. Fees associated with copying can vary depending on the equipment used and the hourly-rate of pay of the individuals who prepare the copies for production; and
- Add a provision to clarify that, while staff time is not charged for searching for existing identifiable records, requests for analysis or summary of ISO records are not covered by this policy.

The proposed changes clarify and modernize the policy while maintaining the required consistency with the general policies of the California Public Records Act.

2. Open Meeting Policy

The ISO's Open Meeting Policy, which governs the Board's open meeting practices, has been in place since its adoption 1998. As a corporation, the ISO is not subject to the Bagley-Keene Open Meetings Act that requires state boards and commissions to hold open meetings. However, similar to the statutory provision dealing with public access to records, the Public Utilities Code also requires the ISO to provide public notice of and access to its Board meetings "consistent with the general policies of the Bagley-Keene Open Meetings Act," again requiring that the ISO afford the public "the greatest possible access, consistent with other duties of the corporation." Public Utilities Code section 345.5(b)(4). And consistent with the provision applying to records availability, the statute prohibits the ISO from amending its Open Meeting Policy in ways that would make it "less consistent" with the Bagley-Keene Act than the policy in place in 2002.

Management recommends revisions to the Open Meeting Policy to:

- Add a provision for gatherings that fall outside the scope of the Open Meeting Policy, such as conferences and social or ceremonial occasions, provided that the majority of the members in attendance do not discuss among themselves business that is within the subject matter jurisdiction of the Board. Attendance at open and noticed meetings of standing, advisory or ad hoc committees of the Board by members of the Board who do not serve on those committees, also falls outside the scope of the Open Meeting Policy, so long as the non-serving members in attendance act only as observers. Add a section on meetings and quorums, for consistency with the ISO bylaws;
- Modify the requirement for the ISO to designate a public viewing location of recorded meetings, as the ISO now makes those recordings available on the public website for a period of at least thirty days;
- As all meeting materials are posted publicly on the ISO website prior to the meeting, Management proposes to reduce the number of copies of meeting materials the ISO is required to make available for inspection at the meeting from three copies to one;
- Delete reference to "eminent domain," which is not applicable to the ISO's business; and,
- Delete the provision on executive session participants, which is no longer applicable with the current board structure.

These proposed changes clarify and modernize the policy while maintaining the required consistency with the Bagley-Keene Open Meetings Act as required by the Public Utilities Code.

3. Board Selection Policy

We propose one minor change to the Board Selection Policy. This is the policy that outlines the criteria for establishing a list of candidates for the ISO Governing Board and engaging with ISO stakeholders to rank candidates for consideration for appointment by California's Governor. We propose to add a provision that appointees begin serving only after executing the oath of office. This will avoid any confusion about the effective date of service for a member of the Board of Governors.

4. Corporate Governance Principles

The Corporate Governance Principles policy, which was adopted in 2005 and amended in 2006 and 2010, describes the ISO's governance framework. It summarizes the roles and responsibilities of Board and Management and sets expectations for governors' conduct and procedures for Board meetings.

Management recommends revisions to the Corporate Governance Principles policy to:

- Clarify the requirement for the Board to review the principles in partnership with Management to ensure they reflect best practices;
- Modify the requirement for the Board to "set and monitor compliance with policies and procedures" to better reflect the Board's role in assessing the ISO's compliance with policies, standards and regulatory requirements;
- Modify the requirement for the President and Chief Executive Officer to prepare an annual report to the Board regarding succession planning to a requirement that the CEO engage with the Board on the topic annually;
- Modify references to the "Governors Code of Conduct and Ethical Principles," as the ISO is in the process of consolidating the Governors and Employees codes of conduct into one comprehensive code of conduct;
- Add a requirement that the Board report any actual or perceived conflicts of interest to the Corporate Secretary to ensure appropriate resolution;
- As Board interaction with stakeholders is becoming more common, Management proposes to add an expectation that the Board will establish an effective, independent and respected presence and a collegial relationship with ISO stakeholders; and
- Add time for deliberation by the Governors as a requirement for meeting agenda timing, to reflect best practices.

5. Compliance and Ethics Program Policy

The ISO's Compliance and Ethics Program Policy sets the policy and requirements for the ISO's compliance program. Management recommends revisions to ensure that this policy is consistent with best practices and reflects the experience that Management has gained over the years of administering the compliance program.

Management recommends revisions to the Compliance and Ethics Program Policy as follows:

- As the code of conduct may need to be amended from time to time to make non-substantive corrections, add a qualification that Board approval be required only for any substantive changes to the Code of Conduct;
- Modify references to the "Governors Code of Conduct and Ethical Principles," as the ISO is in the process of consolidating the Governors and Employees codes of conduct into one comprehensive code of conduct; and
- Clarify the requirement for incorporating the types of disciplinary action that may be imposed into all ISO policies. This practice has not been consistent in years past. The ISO has recently established a template that incorporates language for disciplinary action to be taken for non-compliance.

6. Investment Policy

In 1999, Management developed and the Board approved the Investment Policy for ISO corporate funds. The policy was developed to reflect the ISO's conservative investment objectives (safety of principal, liquidity and earnings).

Management proposes modifications to the policy consistent with the original objectives noted above, as well as the following general resources that provide best practices:

- *California Government Code sections 53601 and 53635* – these sections outline allowable investments for municipalities in California,
- *"Investment Policy Reporting Practices: an informational guide", California Debt and Investment Advisory Commission* – a guide released to provide local California agencies with examples of common reporting practices that may add to the readability of their investment policies and assist in assessing the benefits and risks of the agency's investment goals and priorities ,
- *"Sample Investment Policy", Government Finance Officers Association* – a sample investment policy containing best practices for government agencies or like entities; and,

- *“Elements of an Investment Policy Statement for Institutional Investors”, CFA Institute* – a global association of investment professionals that sets the standard for professional excellence in the investment industry.

Additionally, the ISO conducted a review of the investment policies of other ISOs and major municipalities to ensure that best practices were considered and implemented where appropriate.

Management recommends revisions to the Investment Policy to:

- Delete references to the ISO Medical Retiree Plan Trust (VEBA Trust), including appendix D. Management is considering changes to the investment of funds in the VEBA Trust and will reflect those changes in a separate investment policy specific to the VEBA Trust, which will be presented to the Board for consideration at a future date. The VEBA Trust will continue to be invested under the existing policy until such time;
- Modify the criteria for the selection of external investment managers. The current policy sets a prescriptive list of qualifications. This list has been replaced with language from the CFA Institute, which gives the CFO the authority to hire external investment managers and report on their status quarterly to the ISO’s Corporate Management Committee and annually to the Board of Governors;
- Modify the criteria for the selection of a custodian. The current policy sets a prescriptive list of qualifications. Management feels this could force a custodian transfer for the wrong reason, such as the decline in the custodian bank credit rating. In today’s credit environment, many financial institutions are struggling to maintain their credit ratings, including the handful of banks that can provide institutional custody services. A bank’s long-term credit rating has no correlation to the risk of custodied assets at the bank. Assets held in custody are not commingled with the bank’s assets, and would quickly be assumed by another custody bank should insolvency arise;
- Modify the criteria for the selection of an acceptable firm for third party portfolio review to remove the detailed criteria for an acceptable firm. This detail limits the choices of qualified firms that can provide these services and increases the costs to comply with no added benefit;
- Clarify the application of portfolio percentage limitations for consistency with the intended direction of the policy’s provision. The percentage limitations should be viewed at the date of the purchase of an individual security. Those percentages will

vary after purchase due to changes in the overall size of the ISO portfolio, market value changes of individual positions, and sales of securities

- Modify the maximum percentage allocation for authorized investments. To allow for short-term investments in commercial paper, Management proposes separating commercial paper from the corporate debt obligations category. Management also proposes to increase the maximum allocation of bank obligations from 50% to 100% in periods of market turmoil or great liquidity needs; and
- Modify the process for reporting sale of securities prior to maturity for consistency with actual procedures. All realized gains and losses are reported to the Corporate Management Committee and recorded in the financial statements.

CONCLUSION

Management recommends that the Board approve the proposed revisions to ensure that the documents align with the current corporate structure, law and best practices.