FOR CONSIDERATION
September 27, 2017

TO: The Trustees

FROM: Thomas Falcone

SUBJECT: Establishing and Funding of an OPEB Section 115 Trust

REQUEST: Approval to Establish a Section 115 Trust for OPEB Expenses related to Long Island Power Authority Employees and approval of the Investment Policy associated with such Section 115 OPEB Trust

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Requested Action

The Trustees are being requested to approve a resolution authorizing the Long Island Power Authority (the "Authority") to enter into an Other Post-Employment Benefits ("OPEB") Trust Agreement ("OPEB Trust" or "Trust") to meet the future obligations for post-employment benefits ("OPEB Expenses") provided to former employees of the Authority who meet the eligibility requirements, including their dependents and beneficiaries (collectively, the "Beneficiaries"). The Trustees are also requested to approve an Investment Policy for the Trust assets, and to appoint the Chief Financial Officer as "Trustee" and the Chief Executive Officer as the "Authorized Officer".

Background

On December 17, 2014, the Trustees approved the establishment of an OPEB account for the purpose of establishing a reserve for the payment of future OPEB Expenses for both the Authority and PSEG Long Island employees. Currently, the Authority is depositing the actuarially determined annual expense into an existing OPEB account, however, those assets remain available, if deemed necessary by the Chief Executive Officer or the Chief Financial Officer, to pay operating expenses and debt service of the Authority. Therefore, those assets do not qualify as contributions to fund the OPEB liability under Governmental Accounting Standards ("GASB"). The Authority is requesting to establish a Section 115 Trust dedicated to OPEB Expenses for amounts related to the Authority employees to obtain the accounting advantages provided under GASB Statement No. 75 as discussed below.

The PSEG Long Island OPEB liability is a contractual liability and not subject to GASB Statement No. 75, and therefore, no benefit would be derived by depositing those assets into an irrevocable trust. Its actuarially determined annual funding will continue to be deposited in the existing OPEB account.

Discussion

In June 2015, GASB issued Statement No. 75 addressing accounting and financial reporting for OPEBs provided to the employees of state and local governmental employers. Under GASB

Statement No. 75, the Authority may recognize more advantageous accounting treatment if its OPEB plan assets are maintained in a dedicated trust. Such advantages include:

- Increased assumed discount rate used in the actuarial assumptions;
- A direct offset of the OPEB liability with the OPEB Trust assets thereby improving the Statement of Net Position (balance sheet); and,
- Reduced annual employer contribution and expense.

The Authority is recommending the establishment of a tax-exempt Section 115 OPEB trust. A Section 115 OPEB trust does not require an IRS private letter ruling. As such the Section 115 OPEB trust is generally less expensive than a Voluntary Employee's Benefit Association ("VEBA") trust. A Section 115 OPEB trust qualifies as a dedicated trust under GASB Statement No. 75, as the assets of the plan, contributions and earnings thereon are irrevocable. The Section 115 OPEB Trust plan assets will provide OPEBs to plan members, and the plan assets are legally protected from creditors.

As of August 31, 2017, the Authority has approximately $138.0 million in the existing OPEB account. To minimize the all-in-cost of establishing the trust, the Authority is recommending to fully fund the OPEB Trust using the existing funds available in the OPEB account. Depending on the investment return assumed on plan assets, the initial deposit to fully fund the Trust will range from $16 million to $21 million.

In 2018, the actuarial study will be updated to reflect this transfer of funds and appropriately recalculate the future funding requirements of both the Authority's and PSEG Long Island's OPEB obligations. Upon creation of the OPEB Trust, which is irrevocable, amounts deposited in the OPEB Trust will reduce the Authority's unfunded OPEB liability.

Authorization is also requested to appoint the Chief Financial Officer as "Trustee", and the Chief Executive Officer as the "Authorized Officer" under the Trust. The Authorized Officer is authorized to give directions to the Trustee pursuant to the terms of the Trust Agreement.

OPEB trusts are considered fiduciary funds in accordance with Governmental Accounting Standards and financial data for component units that are fiduciary in nature are only required to prepare a Statement of Fiduciary Net Assets and the Statement of Changes in Fiduciary Net Assets. The Trust will also be required to have an investment policy (attached hereto) which is consistent with the existing OPEB investment policy and issue a separate Investment Report. The Authority does not expect any incremental audit fee related to these additional statements.

<u>Recommendation</u>

The Authority is recommending the establishment of a Trust to be known as the Long Island Power Authority OPEB Trust, which will be an entity separate from the Authority, for the exclusive purpose of providing funds to provide OPEB benefits, with the intent that (i) the income of the Trust will be exempt from federal and state income tax (under Internal Revenue Code Section 115 with respect to federal income tax), (ii) transfers to the Trust will not be taxable to Beneficiaries, (iii) contributions to which will constitute funding of OPEB under GASB Statement No. 75, and

(iv) all assets of the Trust will be irrevocably dedicated to providing OPEB benefits and paying expenses of administering the Trust, and will not be available to any creditors of the Authority.

The Authority is recommending to fully fund the OPEB Trust for the Authority's OPEB liability with an initial deposit ranging from $16 million to $21 million.

Based on the foregoing, I recommend approval of the above-requested action by adoption of a resolution in the form of the attached draft resolution.

Attachments
Resolution
OPEB Investment Policy

Exhibit A

RESOLUTION AUTHORIZING THE ESTABLISHMENT AND EXECUTION OF AN OTHER POST-EMPLOYMENT BENEFITS (“OPEB”) TRUST AGREEMENT (“OPEB TRUST” OR “TRUST”)

WHEREAS, the Board of Trustees (the “Board”) of the Long Island Power Authority (“LIPA” or the “Authority”) has determined that it is desirable for the Authority to establish a Trust to be known as the Long Island Power Authority OPEB Trust, which will be an entity separate from the Authority, for the exclusive purpose of providing funds for OPEB benefits to former employees of the Authority who meet the eligibility requirements, including their dependents and beneficiaries; and

WHEREAS, in connection with the establishment of the Trust, the Board is desirous of appointing the Chief Financial Officer as Trustee and the Chief Executive Officer as the Authorized Officer pursuant to the terms of the Trust, and adopting an investment policy consistent with the Authority’s investment policy as it relates to current OPEB obligations.

NOW, THEREFORE, BE IT RESOLVED, that the Board of Trustees hereby authorizes the following:

1. The establishment of an Other Post Employment Benefit Trust to be known as Long Island Power Authority OPEB Trust;

2. The appointment of the Chief Financial Officer as Trustee and the Chief Executive Officer as the Authorized Officer pursuant to the terms of the Trust; and

3. The adoption of the investment policy consistent with the Authority’s investment policy as it relates to current OPEB obligations.

Dated: September 27, 2017

OTHER POST-EMPLOYMENT BENEFITS ("OPEB") TRUST INVESTMENT POLICY

PERMISSIBLE INVESTMENTS

The Authority may invest in the vehicles listed below provided the Financing Documents have been amended to permit such purchase or such banks have waived any applicable restrictions in such agreements relating to such purchase.

1. Obligations of the U.S. Government, and of an agency of the U.S. Government directly guaranteed or insured by the U.S. or de facto guaranteed by the U.S. Government, including without limitation the Federal National Mortgage Association, acting without specific U.S. Government guarantees as obligors or as trustees for obligations of affiliation of subsidiary entities, and including notes insured by the Farmers Home Administration.
2. Obligations at the time of their purchase rated "BBB-" or better by S&P or "Baa3" or better by Moody's. If a corporate issuer is downgraded, the Investment Manager shall immediately notify the Chief Financial Officer. Securities payable in U.S. dollars shall consist of:
   a) U.S. transportation, utilities, industrial, commercial or financial companies
   b) U.S. Government agencies not included under (1) above
   c) Obligations of state and local governments
3. Mortgage Pass-Through Obligations, Collateralized Mortgage Obligations, and Corporate Mortgage Obligations rated "AA" or better by S&P or "Aa" or better by Moody's.
4. Commercial Paper rated "A-1" by S&P and "P-1" by Moody's.
5. Domestic and Yankee Certificates of Deposits and Banker's Acceptances of domestic banks with minimum long-term ratings of "A-" by S&P or "A3" by Moody's and minimum short-term ratings, if applicable, of "A-1" by S&P or "P-1" by Moody's.
6. Short-term money market mutual funds, investment accounts, or "sweep accounts" that conform to the permissible investments under (1-5) above.
7. Portfolios or funds of securities designed to replicate the composition of benchmark market indices, such as those provided by Barclay's, CRSP, Dow Jones, FTSE, MSCI, Russell, and S&P.

PORTFOLIO RESTRICTIONS

Investments in the above-mentioned securities are limited by the following:

1. No more than 5% of the portfolio may be invested in the securities of any one issuer except for U.S. government/agency securities.
2. No more than 25% of the portfolio may be invested in securities of issuers in the same industry except for U.S. government/agency securities.
3. No more than 20% of the portfolio may be invested in municipal securities.
4. No more than 15% of the portfolio may be invested in notes and bonds rated "BBB" category and no more than 30% of the portfolio may be invested in notes or bonds rated in the "BBB" and "A" categories. The overall rating of the fixed income assets shall be at least in the "A" category. If

an obligation is “split-rated”, the lowest of the ratings will be used to determine compliance with this requirement.

5. Investments in the securities or other obligations of the Authority, the investment managers, the custodian, their parents or subsidiaries are prohibited.

PERFORMANCE OBJECTIVE

The Authority believes that to meet the OPEB Trust’s objectives of funding future liabilities for such benefits while balancing long-term risk and return and providing reasonable diversification, the OPEB Trust should allocate assets in accordance with the targets for each asset class as follows:

Asset Class	**Asset Weighting**
Domestic Equities or Mutual Funds	45%
International Equities or Mutual Funds	20%
Fixed Income Investments	20%
Fixed Income Investments – Inflation Protected Securities	15%

Equity investments should replicate low cost market index strategies rather than attempting individual security selection.

Fixed income investments should be managed to track the Barclays U.S. Treasury Inflation Protected Securities Index[1] or the Barclay’s Capital U.S. Float Adjusted Aggregate Bond Market Index. The fixed income’s portfolio’s duration should fall within a range of 20% below the duration of the index and 10% over the duration of the index.

The portfolio should be rebalanced on a quarterly basis when any asset class falls outside of a 5% range of its asset weighting.

To the extent that the Authority invests funds in a commingled fund or an SEC registered mutual fund or exchange traded fund whose investment objectives and policies are consistent with this Investment Policy, the Authority shall be in compliance with the investment objectives, portfolio restrictions, and performance benchmarking of the policy, and the investments shall be analyzed based on the fund viewed as a whole and not the constituent holdings of the fund.

The Authority recognizes that from time to time it may be necessary to hold cash and marketable securities for a short time frame pending investment or for other reasons.

[1] Includes the inflation-indexed securities within the Barclays U.S. Treasury Bond Index, which represents U.S. Treasury obligations with maturities of more than one year.