

**LONG ISLAND POWER AUTHORITY**

**MINUTES OF THE FINANCE AND AUDIT COMMITTEE MEETING**

**HELD ON SEPTEMBER 27, 2018**

*The Finance and Audit Committee of the Long Island Power Authority (the "Authority") was convened at 9:06 a.m. at LIPA Headquarters, Uniondale, NY, pursuant to legal notice given on September 21, 2018 and electronic notice posted on the Authority's website annually.*

*The following Trustees of the Authority were present:*

**Shelly L. Cohen, Committee Chair  
Elkan Abramowitz, Committee Member  
Mark Fischl, Committee Member  
Drew Biondo  
Matthew Cordaro  
Peter Gollon**

**Representing the Authority were Thomas Falcone, Chief Executive Officer; Anna Chacko, General Counsel; Rick Shansky, Vice President of Operations Oversight; Kenneth Kane, Interim Chief Financial Officer, Bobbi O'Connor, Vice President of Policy & Strategy and Secretary to the Board of Trustees; Donna Mongiardo, Vice President and Controller; Kathleen Mitterway, Vice President of Audit; Corey Horowitz, Director of Risk Management; Jessica Swenson, Utility Enterprise Risk Manager; and Richard Muzikar, Enterprise Risk Management Advisor.**

**Representing PSEG LI were Daniel Eichhorn, President and COO; David Lyons, Vice President of Construction and Operation; Richard Tinelli, Manager of Regulatory Requirements; Robert Green, Manager of Insurance and Risk.**

**Also in attendance were Todd Fowler and John Pontecorvo from KMPG; T.J. Bradley and Michael Hogue, via phone, from Arthur J. Gallagher.**

*Chair Cohen welcomed everyone to the Finance and Audit Committee meeting of the Long Island Power Authority Board of Trustees.*

*Chair Cohen stated that the first item on the agenda is the adoption of the minutes from the July 25, 2018 Committee meeting.*

*Upon motion duly made and seconded, the minutes of the July 25, 2018 meeting were approved unanimously.*

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*Chair Cohen stated that next item on the agenda is the Overview of Financial Results.*

*Ms. Mongiardo presented the Overview of Financial Results, and Mr. Lyons and Mr. Tinelli of PSEG LI reported on the PSEG LI Operating Results and then took questions from the Trustees.*

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*Chair Cohen stated that next item on the agenda is the Overview of the Quarterly Financials Ended June 30<sup>th</sup> to be presented by Donna Mongiardo.*

*Ms. Mongiardo presented the Overview of the Quarterly Financial ended June 30<sup>th</sup> and took questions from the Trustees.*

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*Chair Cohen stated that next item on the agenda is the Discussion of Independent Auditor's 2018 Audit Plan to be presented by representatives from KPGM, Todd Fowler and John Pontecorvo.*

*Mr. Fowler and Mr. Pontecorvo presented the Discussion of the Independent Auditor's 2018 Audit Plan and took questions from the Trustees.*

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*Chair Cohen stated that next item on the agenda is the Discussion of Internal Audit Activities which would be presented by Kathleen Mitterway.*

*Ms. Mitterway gave a presentation regarding the Authority's Internal Audit Activities and then took questions from Trustees.*

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*Chair Cohen stated that the next item on the agenda is Annual Report and Amendments to the Board's Policy on Enterprise Risk Management which would be presented by Corey Horowitz, Robert Green, and representatives from Arthur J. Gallagher.*

*Mr. Horowitz, Mr. Green and representatives from Arthur J. Gallagher presented the following action item and took questions from the Trustees:*

### **Requested Action**

The Finance and Audit Committee of the Board of Trustees of the Long Island Power Authority (the "Board") is requested to adopt a resolution recommending: (i) that the Long Island Power Authority and its subsidiary, LIPA (collectively the "Authority" or "LIPA") has complied with the Board Policy on Enterprise Risk Management (the "ERM Policy" or "Policy"); (ii) approval of the annual report for the Policy; and (iii) approval of certain amendments to the Policy, which resolution is attached hereto as Exhibit "A".

### **Background - Board Policy on Enterprise Risk Management**

By Resolution No. 1351, dated March 29, 2017, the Board adopted the ERM Policy, focusing on the identification, assessment, management and mitigation of risks. The Finance & Audit Committee ("F&A Committee") of the Board, in its charter, was delegated the responsibility of reviewing the Authority's practices relating to Enterprise Risk Management. The Authority's Service Provider, PSEG Long Island, also participates in the implementation of the Authority's ERM Program. There are certain ERM Program requirements, which are described below.

### **Compliance with the Policy**

Staff recommends that, for the reasons set forth below, the Board find that the Authority has complied with the objectives of the Policy for the period since the last annual report.

The Policy provides for "Maintaining an Executive Risk Management Committee consisting of the Chief Financial Officer and at least two other Authority staff appointed by the Chief Executive Officer, one of whom must be a member of the senior management of the Authority, to establish processes and controls and oversee the implementation of the Enterprise Risk Management program".

- The Authority has an active ERMC that reviews the ERM process and controls and oversees the implementation of the ERM Program.
- Currently there are seven members on the Committee including the CEO, Interim CFO, the VP Policy, Strategy & Administration and other Staff at the Director level.

- **The ERMC maintains an ERM procedures manual and meets with ERM Staff on a regular basis. Over the last twelve months, the ERMC has met seven times to discuss the ERM Program.**

**The Policy requires that the Authority “Regularly assess the risks facing the Authority and providing updates on the status of risks and corresponding mitigation activities to the senior management of the Authority and its Service Provider as well as at least annually to the Finance and Audit Committee of the Board of Trustees”.**

- **In 2018, the Authority and PSEG Long Island revised the ERM Program to follow a bottom up approach to engaging each of the business units at LIPA and PSEG Long Island. ERM staff from the Authority, PSEG Corporate and PSEG Long Island collectively facilitate working sessions with the appropriate subject matter experts in each business unit.**
- **The ERM process includes the identification of risks affecting LIPA’s goals and objectives and utilizes quantitative and qualitative methods to assess the magnitude of the risk exposure. The ERM process includes a review of the mitigation of each risk.**
- **Each department Vice President is required to review and sign off on the risks and mitigation activities within the business units of their department as risk-owner.**
- **A formal presentation of the significant risks and mitigation activities of each department is made to LIPA’s ERMC and the Senior Leadership Team at PSEG Long Island.**
- **Annually, the F&A Committee receives an ERM Program Update highlighting the significant risks facing the organization concurrent with this annual report.**
- **The revised ERM Program has been implemented across all the departments at LIPA and three of the four business units at PSEG Long Island, which is ahead of the schedule anticipated when the program was revised in 2018 (see Goal #75 below), with the balance of the business units to be completed by the end of Q-1 2019.**

**The Policy provides for “Annually reviewing the Authority’s insurance and other forms of coverage against insurable risks, including the availability and desirability of such coverage.”**

- **Each year the Authority and its insurance advisor oversee the placement of various policies by PSEG Long Island such as property insurance and general liability insurance and other required coverages as deemed prudent to protect the interest of the Authority’s bondholders and customer-owners.**
- **The Authority’s CFO provides written notification to PSEG Long Island regarding the renewal of required policies, desired changes in coverages, and any requests to investigate other types of coverages. The CFO’s notification is sent each December.**
- **The Authority maintains several other insurance policies including directors and officers liability, premises general liability and property insurance as well as cyber insurance and employee practices liability insurance.**
- **The levels of coverage were reviewed during 2018 and prudent and economic levels of coverage are in place for each type of policy, including:**
  - **D&O Insurance \$200M Limit/\$1M Retention**
  - **Excess 3rd Party General Liability \$300M Limit/\$3M Retention**

- **Property Insurance (all risks, excludes wires and poles) \$500M/CAT\$300M Limit adder/\$1.5-\$7.5M Retention; includes U.S. Property Terrorism**
- **Cyber Insurance:**
  - **LIPA named insured on PSEG Long Island’s Cyber Insurance \$15M Limit/\$2.5M Retention**
  - **LIPA Business Office Cyber Policy \$5M Limit/\$10K retention**
- **Nuclear Electric Replacement (NMP2) \$300M Limit/12-week deductible period**
- **Employee Practices Liability Insurance \$5M Limit/\$15K Retention**
- **LIPA premises Liability and Property Insurance \$150K-\$3M Limit/\$0 Retention**

**The Policy provides for “Maintaining business continuity plans for the operations of the Authority and periodically reviewing such plans of the Service Provider.”**

- **The Authority maintains departmental and corporate level business continuity plans (“BCPs”). PSEG Long Island also maintains detailed business continuity plans for each operational area within each business unit.**
- **LIPA and PSEG Long Island’s BCP plans are reviewed annually and were reviewed during 2018.**
- **Alternative operations within the BCPs are tested on a periodic basis to assure the most essential business functions are maintained or returned to service in appropriate time frames.**
- **Most tests have been completed, with the remaining tests and exercises to be completed by the end of 2018.**

**The Policy provides for “Requiring the Authority’s Audit staff to annually undertake a review of the effectiveness and maturity of the Enterprise Risk Management program.”**

- **The Authority’s Internal Audit department will receive the third-party ERM Program maturity assessment and diagnostic report as further described under “Proposed Changes to the Board Policy” below.**

### **Proposed Changes to the Board Policy**

**The Board Policy has been revised for three purposes:**

- **Simplification of language and elimination of duplication, without material change;**
- **A change in requirement from an annual review of the maturity of the ERM Program by Internal Audit to a program effectiveness assessment that is provided to senior management and Internal Audit for review. Staff will undertake an annual program effectiveness and diagnostic assessment by an outside independent entity (e.g. the Corporate Executive Board or Risk Management Society) making a requirement for an additional assessment by Internal Audit redundant; and**
- **Addition of an annual reporting requirement on the Policy to the F&A Committee, consistent with other Board policies.**

## 2018 Work Plan and Other Goals

LIPA's 2018 Work Plan includes the following goal to advance the Policy:

- **Goal #75:** Initiate a department level review of significant enterprise risks with PSEG Long Island, complete risk profiles for three major business units in 2018 and two business units in 2019.

This goal will be completed during the year and the implementation of the revised Program design, with department level reviews, is ahead of schedule.

### Recommendation

Based upon the foregoing, I recommend approval of the above requested action by adoption of a resolution in the form attached hereto.

*A motion was made and seconded, and the Trustees unanimously adopted the following resolution:*

### RESOLUTION RECOMMENDING APPROVAL OF THE REPORT TO THE BOARD OF TRUSTEES ON THE ENTERPRISE RISK MANAGEMENT POLICY

WHEREAS, the Enterprise Risk Management Policy (the "Policy") was originally approved by the Board of Trustees by Resolution No. 1351, dated March 29, 2017; and

WHEREAS, the Board has received the annual Staff report on compliance with the Policy; and

WHEREAS, the Board has reviewed the Policy and affirms that changes to the Policy are required.

NOW, THEREFORE, BE IT RESOLVED, that consistent with the accompanying memorandum, the Finance and Audit Committee of the Board hereby recommends: (i) finding that the Authority has complied with the Policy; (ii) approval the annual report to the Board; (iii) and approval of the updates to the Policy.

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*Chair Cohen stated that the last item on the agenda is the Annual Report and Amendments to the Board's Policy on the Power Supply Hedging Program, which would be presented by Corey Horowitz.*

*Mr. Horowitz presented the following action item and took questions from the Trustees:*

### **Requested Action**

The Finance and Audit Committee (“F&A Committee”) of the Board of Trustees of the Long Island Power Authority (the “Board”) is requested to adopt a resolution recommending: (i) that the Long Island Power Authority and its subsidiary, LIPA (collectively the “Authority” or “LIPA”) has complied with the Board Policy on the Power Supply Hedging Program (the “Policy”); (ii) approval of the annual report for the Policy; and (iii) approval of certain amendments to the Policy, which resolution is attached hereto as Exhibit “A”.

### **Background - Board Policy on the Power Supply Hedging Program**

By Resolution No.1352, dated March 29, 2017, the Board adopted the Policy to maintain an effective commodity hedging program, focused on meeting the expectations of the Authority’s customers for reasonable stability and predictability in power supply costs. The Policy is consistent with utility best practices.

The F&A Committee of the Authority’s Board of Trustees, in its charter, was delegated the responsibility of reviewing the Authority’s practices relating to commodity risk management.

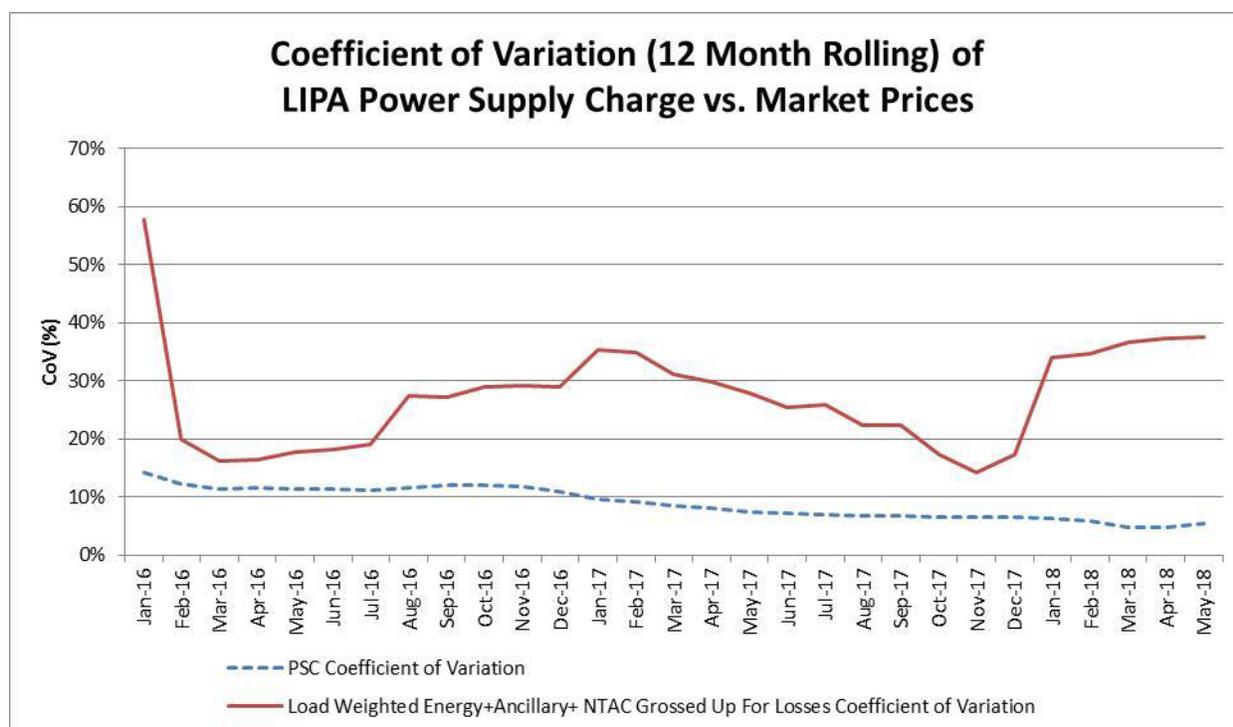
Certain responsibilities, as set forth in the Policy, were delegated by the Board to the Executive Risk Management Committee (“ERMC”).

### **Compliance with the Policy**

Staff recommends that, for the reasons set for below, the Board find that the Authority has complied with the objectives of the Policy for the period since the last annual review.

The Policy is intended to “Mitigate a portion of the volatility of power supply costs in a programmatic and reasonable way on behalf of the Authority’s customer-owners.”

- The ERMC approves the LIPA Hedge Plan which identifies certain power supply cost components which can be fixed to create reasonable and stable rates. In general, hedging these cost components has proven to reduce the Power Supply Charge (“PSC”) volatility in the absence of a hedging program and purchasing power in the open market. PSEG Energy Resource and Trade (“PSEG ER&T”) presented to the F&A Committee at the July 25, 2018 meeting the following graph indicating the actual PSC volatility as compared to the volatility customers would be exposed to based upon unhedged market prices.



The Policy shall be “executed using financial derivative and physical supply and delivery contracts for a portion of the Authority’s projected fuel and purchased power purchases, provided, however that: the net hedge position does not exceed 90% of projected fuel and purchased power needs; the term of any such hedge does not exceed ten years without the prior consent of the Board or a term in excess of sixty (60) months without the prior approval of the Finance and Audit Committee of the Board.”

- PSEG ER&T authorized traders execute both financial and physical hedge transactions on the Authority’s behalf for defined volumes over a 48-month period. All transactions are monitored by PSEG Enterprise Risk Management (“PSEG ERM”) back office for compliance; PSEG ERM generates and distributes hedge ratio position reports daily, weekly and monthly to the Authority’s ERMC staff.
- Hedge transactions are triggered based on a time or value trigger protocol that has been established with an independent third-party hedge advisor. Time-trigger transactions allow for the accumulation of minimum required volume hedge levels under all price environments, value-triggered transactions allow for the accumulation of additional hedge levels based on lower decile pricing levels of value versus 4-year historical pricing. In addition, volumes associated with Board Approved Purchase Power Agreements (“PPAs”) having fixed prices and the Authority’s 18% ownership of Nine Mile Point 2 are included as part of the hedged volume. Currently, the ERMC has set a maximum hedge level limit of 85%.
- No hedges exceed a term of sixty months and the net hedge position does not exceed 90% of projected fuel and purchased power needs, meeting the requirements of the policy.

The Policy states that it shall “Achieve appropriate risk mitigation and is not for purposes of financial speculation.”

- All transactions are based on ERMC Approved projected fuel and power requirements associated with the Authority Approved annual sales forecast. Specific power supply component volumes are also validated against historical consumption data. Each hedge transaction is reviewed by PSEG ERM's middle-office risk management group for compliance to ERMC approved Hedge Plan and procedures.
- The Policy states that it shall "Provide transparency regarding the Authority's commodity risk management activities and the results of such activities."
- PSEG ER&T and PSEG ERM provide to the ERMC staff on a daily basis a hedge transaction report, hedge position report and position valuation report. In addition, the following table identifies several other required reports to the ERMC, their distribution and reporting frequency and the originator of the reports.

Report	Distribution	Normal Frequency	Originator
Trading Activity Summary	ERMC Traders	Weekly	Middle Office
Position Report	ERMC Traders	Weekly	Middle Office
Credit Risk Exposure Reports	ERMC Traders	Weekly	Middle Office
ERMC Meeting Minutes	ERMC	As Meetings are Held	ERMC Designated Secretary
Benchmarking	ERMC	Quarterly	Independent third-party hedge advisor
Risk Management Activities	Board Finance & Audit Committee	At least four times per year	CFO or designee

The Policy requires "Ensuring that all Power Supply Hedging Program activities are in accordance with this Board Policy Statement".

- All active participants of the Power Supply Hedging Program are required to read and comply with the ERMC Approved Policies, Control and Procedures Manual for Power Supply Hedging ("Manual"), which incorporates the Board Policy. All active participants are required to certify compliance with the Manual and Policy by executing the Yearly Certification of Compliance with Risk Management Policy and Procedures Form.

The Policy requires "Determining the Authority's tolerance for exposure to fuel and purchased power price movements and power supply cost volatility taking into account the costs of limiting such exposure."

- The ERMC has approved a Manual for the hedging program that establishes the Authority's tolerance for exposure to fuel and purchased power price movements. The ERMC has established minimum and maximum hedging limits by time-period as well as collateral posting limits.
- The cost of the hedging program is evaluated each day in the form of mark-to-market value of the positions and stress testing collateral exposure potential of all positions execute to limit PSC volatility.

The Policy requires "Addressing all risk factors that are demonstrably quantifiable, actionable and material to the program."

- The ERMC approved Manual specifically identifies authorized markets and delivery points, permissible hedge instruments and the terms and volumes available for hedging to reduce PSC volatility. Within the Manual there is also a specific LIPA Hedge Plan that addresses the PSC hedge components that are quantifiable, actionable and there is market liquidity available to hedge the required products and delivery points (i.e. natural gas, gas basis, power, power basis).

The Policy requires "Establishing risk boundaries consistent with such tolerances and evaluating allowable financial and physical instruments in executing the Power Supply Hedging Program."

- The ERMC approved Manual specifically identifies authorized markets, delivery points, permissible hedge instruments, terms and volumes associated with hedging to reduce PSC volatility. Within the Manual there is also a specific LIPA Hedge Plan which addresses minimum and maximum hedge levels by time-period – consistent with utility peers.

The Policy requires "Establishing appropriate processes and protocols to review and monitor counterparty credit worthiness on a regular basis."

- The Manual identifies specific procedures carried out by PSEG Credit Risk Management on behalf of the Authority for managing and monitoring counterparty credit risk on an on-going basis. PSEG Credit Risk Management provides the ERMC with a credit report each week as noted above.

The Policy requires "Monitoring Commodity Futures Trading Commission rule making and all other regulatory and legal requirements to ensure that the Authority is taking all actions required to maintain compliance with respect to any transactions under the Power Supply Hedging Program."

- PSEG ER&T, PSEG Corporate Legal department and the Authority's outside counsel monitor Commodity Futures Trading Commission regulatory rule-making to determine what actions, if any, the Authority is required to undertake to assure continued compliance.

#### **Proposed changes to the Board Policy**

The proposed amendments to the Policy include:

- **modifying the hedge term horizon in which the ERM C would require the approval of the Finance and Audit Committee of the Board from sixty (60) months to seventy-two (72) months.**

**The modification is based on observed opportunities to lower month-to-month volatility of power supply costs to the Authority’s customer-owners over a greater period of time;**

- **clarifying the ERM C’s role under the Policy;**
- **recognizing PSEG ER&T’s role on the Authority’s behalf to manage the volatility associated with fuel and purchase power costs to the Authority’s customer-owners;**
- **clarifying LIPA Staff’s oversight responsibility under the Policy;**
- **amending the reporting requirement to the F&A Committee to semi-annual reporting with an annual compliance report; and**
- **certain other non-material wording changes.**

### **Recommendation**

**Based upon the foregoing, I recommend approval of the above requested action by adoption of a resolution in the form attached hereto.**

*A motion was made and seconded, and the Trustees unanimously adopted the following resolution:*

### **RESOLUTION RECOMMENDING APPROVAL OF THE REPORT TO THE BOARD OF TRUSTEES ON THE POWER SUPPLY HEDGING PROGRAM POLICY**

**WHEREAS, the Power Supply Hedging Program Policy (the “Policy”) was originally approved by the Board of Trustees by Resolution No.1352, dated March 29, 2017; and**

**WHEREAS, the Board has received the Staff report on compliance with the Policy; and**

**WHEREAS, the Board has reviewed the Policy and affirms that changes to the Policy are required.**

**NOW, THEREFORE, BE IT RESOLVED, that consistent with the accompanying memorandum, the Finance and Audit Committee of the Board hereby recommends: (i) finding that the Authority has complied with the Policy for the period since the last review; (ii) approval of the report to the Board; and (iii) approval of the updates to the Policy.**

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*Chair Cohen then entertained a motion to adjourn, which was duly made and seconded, after which the meeting concluded at approximately 10:12 a.m.*

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