

# Reassessment of FTR Credit & Market Risk

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# Topics To Be discussed

- FTR default risk not unique to PJM
- Brief review of ISO-NE FTR Credit approach
- Solution to FTR credit concerns needs to be addressed on several fronts

# FTR Default Exposure Not Unique to PJM

- Common component of all RTOs FTR credit approach is reliance upon historical returns
- Flaw with such approach is that many variables dramatically influence congestion patterns and FTR returns
  - “Past returns do not guarantee future performance”
- It appears unlikely that any reasonable margining scheme based solely upon past returns would have adequately “predicted” the degree of negative returns experienced in PJM
- Transmission outages (planned & unplanned), new transmission facilities, Generator additions / retirements / outages (unplanned) all contribute to congestion patterns altering from historical norms

# Highlighted Differences Between PJM & ISO-NE FTR Credit Policies – Congestion Risk

ISO-NE	Comments
Forecast future congestion <u>losses</u> through use of monthly returns over prior 3 yrs (Long-term: 75% worst expected monthly value; Short-term: 95% worst expected value)	Use of monthly returns addresses variable congestion patterns. For annual FTR assumes that 75% worst month occurs 12 months in a row.
Forecasted congestion credits are <u>not</u> permitted	Forecast only meant to increase margin, not to lower it
Paths are individually margined with individual net credits permitted to offset other path obligations	This limited application of portfolio margining does not account for correlations
“Sell” transactions have no margin requirement	With present margining approach selling positions does not increase risk
No Mark-to-Market function	No current means to determine change in market appetite for future positions – i.e., no BoPP, no ability to trade greater than prompt month in ISO secondary market
No ability to force liquidation of defaulted portfolio	Value of liquidation rights are diminished without the means to liquidate entire forward position

# Opportunity for Improvement Across Several Fronts – Budget & Finance

- Must integrate risk management methodologies commonly used in commodities markets
  - Initial margin: measure of possible change in market value between opportunities to liquidate
  - Mark-to-Market / Variance margin: revalue portfolio based upon prevailing market prices (M-t-M), alter margin requirements accordingly (Variance margin)
  - Settlement Margin: Adjust margin requirements as approach position settlement – accounts for increased variability and liquidity risk
  - Super-Margin: the ability to request margin in excess of calculated levels to address changes in market/participant conditions not otherwise accounted for
  - Position limits: evaluate merits of limiting size of FTR portfolios
- Closer review of benefits afforded to improving M-t-M opportunities
  - Introduce more frequent auctions?
  - Create “balance of planning period” auctions?
  - Opportunity to enhance ISO supported secondary market functionality?
- Utilize forward forecast of congestion to supplement historical based margin calculations
  - Without the existence of market prices for future positions, ISO-NE must utilize forecasting approach to measure potential congestion risk

# Opportunity for Improvement Across Several Fronts – Budget & Finance (cont'd)

- More robust use of traditional portfolio margining techniques
  - Evaluate risk at the portfolio level rather than by individual paths
- Limit available Financial Assurance types for margining financial markets
  - Move in-line with futures markets and evaluate option of eliminating use of non-liquid FA types (i.e., Credit Limit, Guaranty)
- Opportunity to institute specific quantitative/qualitative qualification criteria for FTR participation
  - Example:
    - Qualitative: evidence of trading/risk management experience
    - Quantitative: minimum capitalization levels
  - Discuss merits of alternate approach for hedgers v. speculators
- Improve Market Participant protections from exposure to FTR Participant bankruptcies
  - Align FTR market treatment to maximize futures market protections under US Bankruptcy code
- Review current default allocation methodology to assess opportunities for enhancement
  - Should FTR defaults be allocated differently?
  - FTR Guaranty Fund?

# ISO-NE Evaluating Improvements Across Several Fronts - Other

- Membership Committee
  - Evaluate best practices in an effort toward strengthening the new membership qualification process
  - Assess merits of additional qualification criteria to participate in Financial markets
  - Investigate options for addressing concerns pertaining to multiple affiliate participants active in financial markets (i.e., FTR, Virtual)
- Market Monitoring
  - Actively working on report assessing current FTR market design
  - Evaluate opportunities to enhance systems designed to monitor bidding behavior in FTR/Virtual markets particularly as it may relate to affiliate FTR bidding
- NEPOOL Markets Committee
  - Work with Credit to evaluate possible options for liquidating defaulted positions
  - Will be asked to evaluate the merits of eliminating the FTR-Only sector (requiring full Market Participant status to participate in FTRs)
  - Information Policy:
    - Modify (as necessary) information policies to permit the ISO increased flexibility to share relevant information to Participants in event of default
    - Clarify ISO/RTO Council information policy to promote increased transparency among ISO/RTOs concerning Participants' market and financial information
- Other
  - Closer review of LTTR market design and feasibility in light of recent events