

## Meeting Notes

### **FTR/LTTR Credit Working Group March 5, 2008 ISO New England, Holyoke, MA**

The following matters were discussed:

#### ***Working Group Charter:***

Following introductions by those attending the in-person-only meeting, the meeting began with a discussion of the working group's mission – to explore and evaluate, in part based on lessons learned from PJM's FTR market default experience, and in part as an extension of work already having commenced in consideration of the pending LTTR market, revisions to the ISO's financial assurance and billing policies to further mitigate the risk associated with FTR/LTTR market activity. A broader discussion of whether changes beyond the financial assurance and billing policies were desirable was also being organized and would likely be scheduled in conjunction with a future Markets Committee meeting. Thoughts or proposals on revisions touching other areas of the RTO arrangements (e.g. Market Rule, Information Policy, or Membership changes) would be examined within the confines of this working group, however, such issues would be ultimately referred, as appropriate, to the proper committee for further consideration.

#### ***Stakeholder Appetite for Counter-Party Risk:***

The general consensus being that there was little to no tolerance for uncovered risk in the FTR/LTTR market, and that the group should strive to implement the broadest coverage permitted by the FERC, the group's discussion touched on the following areas:

- by way of example, the levels of risk undertaken in other organized electricity markets, financial markets and by individual Participants in dealings with their counterparties
- Participant risk tolerance in the New England markets; the New England FTR Market may be concentrated (approximately 40 Participants, with roughly half owning assets and the other half taking speculative positions) though there were a variety of opinions on whether and how to assess concentration concerns
- differentiating financial assurance treatment and market participation based on different identified risk profiles
- the feasibility of aligning the rules and procedures for FTR Market margining to be more in line with those of NYMEX and other commodities exchanges
- whether and how financial assurance calculations should take into consideration "stress tests" (e.g. generation and line outages) or market/position concentration

It was noted that historically the FERC's position with respect to risk exposure, as confirmed recently in the Franklin Power/GLE Trading membership proceeding, had been to "balance the goals of allowing the ISOs and RTOs to reduce their risk of exposure in the event of payment defaults while at the same time ensuring that the credit requirements are not so stringent that they unnecessarily inhibit access to the marketplace." There was a suggestion that the region should consider exploring the FERC's receptiveness to more stringent requirements, particularly with

respect to FTR activity. Mr. Ludlow reported on recent FERC outreach to the RTOs/ISOs in this area, and conveyed a FERC expectation that it would convene a technical conference in mid-spring to discuss best practices.

### ***Existing FTR Credit Policy Overview:***

Mr. Iafrati summarized the elements and requirements of the existing FTR credit policy, highlighting its assumptions based on historical performance and data.

### ***Opportunities for FTR Credit Enhancement (Basis for sub-groups):***

The areas for further discussion and development of straw proposals for enhancements were identified as follows (topics not discussed are highlighted in blue).<sup>1</sup>

#### **Pre-Market Entry**

- 1 Should FTR participants be required to establish expertise prior to market entry?
  - Assess the level of experience and expertise of FTR traders prior to market entry
  - Review of FTR investment strategies, risk management approach and controls
  - More robust credit evaluation of new FTR participants – liquidity measures (funding & asset)?
- 2 Should minimum capitalization thresholds be established
  - Which markets – all/virtuals/FTRs
  - Threshold capitalization model after “Eligible Commercial Entity” status
- 3 Should participant’s credit / default history be factored into market entry decisions
  - Should existing defaults in other markets / ISOs / RTOs preclude market entry?
  - What about forceful terminations from other markets?
    - Opportunity for cross-default triggers on existing Participants?
  - How to prevent simple name change being used to avoid re-entry limitations?

#### **Post Market Entry – Pre Award**

- 4 Exploring Movement to a Clearinghouse/Financial Clearing Merchant (FCM) Model
  - Whether and how to introduce
  - Outsourcing discussion or fixed insurance policy
  - Limitations too sizeable?
- 5 Default Insurance
  - FTR Credit Default Insurance Policy?
    - Cost prohibitive?
  - FTR Guaranty Fund?
    - Funded through FTR market participants
    - Pool funded

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<sup>1</sup> Please note that this list is not exhaustive and additional items will be evaluated as we move through the process.

- 6 Establishing Acceptable Margin
  - How is appropriate value determined?
  - General Margining schemes: Initial margin/Variance Margin
    - Mark-to-Market –v- Mark-to-Model
    - Stress Tests
      - Scenario Analysis
  - Seasonality Adjustment
  - Portfolio margining
  - Lowered Requirements for Bonafide Hedgers

### **Post Market Entry – Post Award**

- 7 How to Address Concentration Risk
  - What metric (directional limits, geographic elements)
- 8 Establishing Position Limits
  - What metric (MWs, notional value, directional limits, geographic elements)
  - Does collateralization resolve issue
    - What about liquidity premiums?
- 9 Liquidation of FTR Position where Holder is in Default
  - Consensus of the group was that it was desirable to create a provision permitting the ISO to liquidate an FTR position if the FTR Holder is in default
  - WG to develop principles/features of liquidation and leave development of mechanism to Markets Committee
- 10 Revising Default Socialization Scheme
  - Setting off against ARR payments
  - FTR Participants to bear partial/full FTR exposure
  - Withhold revenue stream from FTR holders until end of year
- 11 Increased Auction Frequency
  - Balance of Planning Period, more freely traded

### **Other**

- 12 Bankruptcy Considerations
  - FTR Market as a Futures Contract
- 13 Eliminate Unsecured Collateral (Credit Limits/Guarantees)
  - FTR Only
  - Financial Markets (FTR/Virtual)

### ***Next Steps:***

Based on further discussion, the group agreed upon the following tasks:

1. ISO to identify one or more sub-groups to further develop straw proposals and/or working papers on specific sub-set of areas for further consideration. A first pass was made to create such sub-groups as outlined in the previous section (“Pre-Market Entry, “Post-Market Entry...”).

2. Group members would self-select sub-groups to participate in, forwarding as requested thoughts and proposals to J. Iafrati, who would organize, consolidate, and forward to the working group, as appropriate, materials developed in the sub-group efforts. It is likely that the groupings may cause group members to seek participation on many if not all sub-groups. Depending on self-select feedback, the ISO may alter the grouping approach. Please contact J. Iafrati by the end of this week (3/28) indicating which sub-group or particular issue you wish to participate in and whether you would like to provide support material concerning the topic.
3. While the members of the working group who attended the 3/5/08 meeting expressed a preference to convene our second meeting in New York City, we feel it important to poll the entire working group for meeting preference. Please respond to J. Iafrati ([jiafrati@iso-ne.com](mailto:jiafrati@iso-ne.com)) by end of day Thursday March 26<sup>th</sup> indicating your first preference from the following list of potential meeting locations:
  - 1) Boston (Day Pitney office)
  - 2) Westborough (TBA)
  - 3) Holyoke (ISO-NE office)
  - 4) New York City (Day Pitney office)

***Second Meeting:***

The second meeting of the group is scheduled to take place on Friday April 25<sup>th</sup> at a time and location to be defined later. Regardless of the selected location, telephone participation will be made available upon request. It must be stressed, however, that priority will be afforded those participants who are present for the meeting over those monitoring via phone.