

Elegibility Criteria for FTR Market Participation

Prepared For Consideration by
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Market Participant Eligibility Overview: Key Questions

- **Motivation: Without participant eligibility requirements, there are no means to ensure credit worthiness of participants beyond their ability to meet current financial assurance requirements**
- **Core questions needing to be addressed if ISO is given the ability to set eligibility criteria:**
 - Quantitative Criteria: Should there be minimum eligibility requirements for FTR participation?
 - Requirements should be crafted to establish the entity as a sophisticated trader having the financial ability or trading expertise to participate in the market
 - Precedent in Commodity Exchange Act & CFTC regulated markets (among other exchanges)
 - Qualitative Criteria: What qualitative criteria, if any, should be used?
 - Establish experience in trading, risk control, and ability to meet changing collateral levels
 - Requirements likely need to be made prescriptive enough (non-discretionary) such that FERC will approve
 - Enforcement: How should market entry process be structured to allow for concerns around participant eligibility to be addressed?
 - Failure to meet criteria result in FTR market access removal/denial?
 - Adjustment to margin levels?
 - Implement position limits?
 - What cross-market surveillance should be employed?
- **Other markets/exchanges employ eligibility requirements**
 - General approach is part of U.S. Code regarding futures trading
 - Eligible Contract Participant / Eligible Commercial Entity of the Commodity Exchange Act

Quantitative Criteria

- **Goal: Create eligibility criteria to identify sophisticated market participants**
- **U.S. Commodity Futures Trading Commission provides the following:**
 - Eligible Contract Participant: An entity, such as a financial institution, insurance company, or commodity pool, that is classified by the Commodity Exchange Act as an eligible contract participant based upon its regulated status or amount of assets. This classification permits these persons to engage in transactions (such as trading on a derivatives transaction execution facility) not generally available to non-eligible contract participants, i.e., retail customers.
 - Eligible Commercial Entity: An eligible contract participant or other entity approved by the CFTC that has a demonstrable ability to make or take delivery of an underlying commodity of a contract; incurs risks related to the commodity; or is a dealer that regularly provides risk management, hedging services, or market-making activities to entities trading commodities or derivative agreements, contracts, or transactions in commodities.
- **Ontario's Independent Electricity System Operator (IESO) has, for several years, required ECE certification under the Commodity Exchange Act for FTR market access**

Qualitative Criteria

- **Goal: Outline required qualitative tests for participation**
- **Qualitative tests should allow ISO to be satisfied that participants are able to address issues around trading experience and risk management as they pertain to the FTR markets**
 - To meet FERC requirements, need to make tests prescriptive (minimally subjective) in nature
 - Experience in trading and risk management difficult to define
 - Potentially require a track record in other investment products
 - Potentially require participants to define perceived “risks” in FTRs to ISO
- **Commodity Exchange Act provides a starting point by defining eligible contract participants as entities with demonstrated extensive experience in trading and risk management associated with commodity and derivative trading**
 - Other markets requiring entities be Eligible Commercial Entities only require that prospective participants represent that they meet the requirement
 - Use of ECE/ECP criteria may provide sufficient quantitative & qualitative assurances
- **Given the uniqueness of the FTR market - should require participants to complete FTR market training as pre-requisite to market participation**

Recommendations

- **Quantitative**

- Institute eligibility requirement for FTR market participation
 - A. Eligible Contract Participant
 - B. Eligible Commercial Entity
- Failure to meet ECP / ECE requirements
 - A. Denial/Removal of FTR market rights
 - B. FTR FA margin premium
 - C. Establishment of FTR position limit

- **Qualitative**

- Must establish experience in trading and risk management
 - A. Meet ECP / ECE requirements
 - B. Required to complete FTR market training as pre-requisite to market participation

- **Surveillance**

- Good standing status in alternate markets
 - A. Company, its officers and traders must not be subject to any serious regulatory or legal sanctions (CFTC, SEC, FINRA, etc) including censure, suspensions, bans
 - B. Evidence of high risk behavior (cross-default in other energy markets; excessive ISO-NE margin calls and/or late payments) results in margin haircut