



memo

To: NEPOOL Budget & Finance Subcommittee

From: Jennifer Recht, Corporate Counsel

Date: March 26, 2015

Subject: Financial Assurance Policy and Billing Policy Revisions Regarding Collateral for Foreign Entities

This memorandum addresses proposed changes to the ISO New England Financial Assurance Policy (“FAP”) and Billing Policy regarding the types of collateral that foreign market participants (i.e., participants that are not organized under U.S. law) may provide to satisfy their collateral obligations under the FAP.

Background

Pursuant to Section X of the FAP, a market participant that is required to post collateral may provide a letter of credit or cash collateral. If a participant chooses the cash collateral option, such participant must (1) open an investment account with BlackRock, Inc. or its affiliates (collectively, “BlackRock”), (2) complete and execute a Security Agreement, and (3) complete and execute a Control Agreement (which together with the Security Agreement, gives ISO New England (the “ISO”) status as a “perfected,” or first priority secured creditor with respect to the collateral held in the BlackRock account).

The cash provided is invested in one of six investment options (the “Liquidity Funds”) listed on the ISO’s website.¹ BlackRock recently informed the ISO that because of U.S. securities laws, foreign market participants can no longer invest in the Liquidity Funds. The ISO, in consultation with NEPOOL counsel, subsequently engaged in several conversations with BlackRock to determine if BlackRock could offer alternatives to the Liquidity Funds in which foreign market participants could invest, while still providing the ISO with perfected secured creditor status. After much discussion, BlackRock informed us that the only funds available to foreign market participants would be offshore funds (e.g., organized in the Cayman Islands) that issue non-U.S. securities. However, permitting the use of non-U.S. securities to act as collateral for a foreign market participant’s financial assurance obligations presents risks under U.S. and foreign laws, including bankruptcy/insolvency laws, securities laws, and laws governing security interests. Because both U.S. and foreign laws are involved in determining the ISO’s priority status, there is a risk that foreign and U.S. laws would conflict regarding whether the ISO is in fact the first priority creditor. In other words, if the ISO needed to liquidate non-

¹ The six options are BlackRock Fed Fund, BlackRock Muni-Cash, BlackRock MuniFund, BlackRock T-Fund, BlackRock Temp Cash, and BlackRock Temp Fund. If a participant does not select one of the investment options, the default is BlackRock Temp Fund.

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U.S. securities as a result of a foreign market participant's default, there is the potential that another creditor would receive priority claims to that collateral and that the collateral would no longer be available to satisfy the participant's default.

Proposed Changes Regarding Foreign Entities

As a result of BlackRock's new rules prohibiting foreign entities from investing in the Liquidity Funds, the ISO is proposing modifications to the FAP that prohibit a foreign entity from using BlackRock shares as a form of collateral under the FAP unless such entity qualifies for an exemption from BlackRock. We are currently exploring a limited exemption with BlackRock that would allow Canadian market participants that have net assets of at least \$25 million (as shown on its most recently prepared financial statements) to invest in the Liquidity Funds. Currently, BlackRock is seeking internal approvals of this exemption. The ISO will keep affected participants updated on this process.

Effect on Existing Foreign Market Participants

Foreign entities that are currently invested in the BlackRock Liquidity Funds will not be affected by the proposed FAP changes. However, any foreign market participant that is currently invested in an offshore fund (e.g., BlackRock International Dollar Reserve Fund) and that does not meet any applicable BlackRock exemptions will be required to obtain a letter of credit. Currently there are two market participants, both of which are Canadian companies, that are invested in an offshore fund through administrative oversight. These participants will be required to obtain a letter of credit unless they qualify for BlackRock's limited exemption.

Clean-Up Changes

In addition to the above described changes, Section X will be modified to delete references to cash deposits. As previously discussed with the Budget and Finance Subcommittee, cash that is submitted to Blackrock is immediately converted to uncertificated securities in a registered or private mutual fund and such shares are held in a market participant shareholder account (each market participant has its own account). Therefore, references to a cash deposit were replaced with language to more accurately describe the BlackRock relationship.

Similar clean-up changes are being made to the Billing Policy to delete references to cash deposits.