STANDBY LETTER OF CREDIT FORM FOR FINANCIAL ASSURANCE & LIST OF ELIGIBLE LETTER OF CREDIT ISSUERS

NEPOOL Budget and Finance Subcommittee Meeting

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ISO's Standby Letter of Credit (LC) Form

Proposed Effective date: September 1, 2025 with a phased in approach

- ISO-NE's Irrevocable Standby Letter of Credit (LC) Form, Attachment 2 of the Financial Assurance Policy (FAP), lacks several structural features that mitigate the risk of socialized default losses
  - Per the FAP, the ISO can only accept minor, non-material changes to the Form without refiling with FERC
- This presentation introduces these issues to stakeholders, presents the ISO's concerns with the current LC form and shares our approach to address such issues and mitigate the risk
- Additionally, there are two new administrative updates included in the new LC form regarding the "evergreen" clause and drawing certificates presented by email

ISO’s Standby Letter of Credit (LC) Form

Proposed Effective date: September 1, 2025 with a phased in approach

- The ISO’s form LC in the FAP is to cover market obligations; a similar form was used for Order 2023 Commercial Readiness Deposits, which is posted on the ISO’s website but is not filed as part of the tariff
- The ISO will update the Commercial Readiness Deposit Form LC, if applicable, based on the changes discussed herein
- Conforming changes to the body of the FAP are also required

ISO's Standby Letter of Credit (LC) Form

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Outline of today's discussion: Slide

The current ISO Letter of Credit Form ensures payment if a MP fails to pay its invoice on time

- The ISO uses LCs to ensure the timely payment of a Market Participant’s (MP) obligations arising from market activities should the MP fail to pay the ISO (i.e., a billing default)
- The bank wires cash to the ISO upon presentation of a drawing certificate related to a billing default (“a failure to pay”) and these funds are then used to clear the market per the ISO’s weekly settlement billing cycle

There are other scenarios where the ISO’s ability to settle the market may be placed in jeopardy due to the lack of protections within the current LC form

What happens if the MP is unable to replace an LC which is due to expire?

- In a scenario where the MP has been unable to renew, replace or amend the current expiring LC posted to the ISO and that MP continues to have financial assurance requirements (such as FCM Delivery FA over future time periods), the ISO clearly cannot draw on the LC once it expires should a payment default occur thereafter
- Successfully drawing the full notional value of the LC before expiration eliminates this risk

Proposed new mitigation: A new draw trigger, upon failure to renew, replace or amend an existing LC within 30 days of the expiration of the LC will be added to the form LC

What happens if the LC Bank no longer satisfies the ISO's minimum credit rating requirements?

- ISO has several requirements for a Bank to be (and remain) included on its List of Eligible LC Issuers including minimum credit ratings
  - A-, A3 and A-, by S&P, Moody's and Fitch, respectively
- Banks that were previously approved by the ISO that are downgraded below any of these minimum credit ratings are ineligible to post new LCs to the ISO
- After a 5-day grace period (or 20-day grace period, if extended by the ISO) the LC is valued at $0 and MPs are required to replace ineligible existing LCs with those from another bank that satisfies the ISO's requirements including the minimum credit rating requirement
- The ISO is exposed to the worsening credit condition of the bank until the LC is successfully replaced by the MP

Proposed new mitigation: A new drawing right in the LC form upon the downgrade of the LC Bank below the minimum credit rating requirements

What happens currently if a bank is downgraded below the minimum credit ratings but is on the CME approved list of banks?

- The ISO currently accepts Letters of Credit from banks that are on the CME's list of approved banks even if their credit rating is below A- subject to satisfying other criteria outlined in the FAP
- The ISO, therefore, intends to change the LC Issuer eligibility criteria in the FAP such that it no longer refers to CME's list of approved banks as some of those banks are rated below the A- minimum credit rating threshold that the ISO otherwise requires

All Banks on the ISO's List of Eligible LC Banks will be required to satisfy the minimum credit rating requirement of A-

Drawing certificates presented by email offer additional operational flexibility to the ISO

- Currently, the ISO can present a drawing certificate to the issuing LC Bank by means of courier, certified mail, registered mail, or facsimile
- Facsimile is the predominant method currently used by the ISO to present drawing certificates as we can meet the 10:00am presentation deadline for same day payment which wouldn't typically be possible by courier or mail
  - Confirming copies are sent after the fax but the receipt of such by the Bank is not a prerequisite to honor the faxed drawing certificate
- The ISO wants to ensure that it has all standard presentation delivery options available to it in its updated LC form (for example, in cases where the fax is not operational or available)

The new LC form will include additional language to allow presentation of drawing certificates by email

The evergreen clause is now included as a standard option in the new LC form

- Some MPs provide LCs that contain an evergreen clause which permits the automatic extension of the LC for a period of one year beginning on the initial expiration date (and upon the anniversary of such date) unless at least 30 days prior to such expiration the ISO has been notified that it will not be extended
- Currently, MPs are required to request the inclusion of this feature in the LC form; however, the ISO considers it administratively beneficial to offer it as an option within the standard LC form instead of having to repeatedly process the extension of expiring LCs

The new LC form will include additional language to provide the evergreen clause as an option within the standard LC form

ISO is proposing a phased-in approach to implementing the new LC form

- A transitional implementation approach is designed to give MPs adequate time to replace the current LCs with the new LC form during 2025 and 2026
- ISO is considering an effective date on September 1, 2025
- Between September 1, 2025 and June 1, 2026, any LC which is required to be newly posted or replaces / amends an existing LC will be required to be written under the new LC form
- From June 1, 2026 onwards, all LCs posted to the ISO by MPs will be required to be under the new LC form

Including these features in the ISO's LC form are reasonable from a risk management perspective

- Each of the proposed drawing features has precedent in other Letter of Credit forms required by other ISOs / RTOs
- The vast majority of banks on ISO's Eligible Bank LC Issuer List currently underwrite LCs which allow the presentation of the drawing certificate by email
- The ISO is interested in understanding if any of our stakeholders have any concerns with including these new drawing features in the Sample Standby Letter of Credit form (FAP Attachment 2) for financial assurance
- Given the protections afforded by LCs with these additional risk mitigation features, the ISO considers them a reasonable and prudent addition to our standard LC form

Stakeholder Process and Next Steps

Steps	Timeline
Initial discussion with Budget and Finance Subcommittee	March 25th
Presentation of Redline Standby Letter of Credit Form and FAP	April 15th
Vote at the Participants Committee	May 1st
FERC Filing	May-June
Effective Date	September 1, 2025 including a transitional implementation period