

Verification of Market Participant Risk Management Procedures

Sheri Prevratil – *Manager, Corporate Credit*
New York Independent System Operator

Credit Policy Working Group
October 28, 2011

Background

- ♦ FERC Order 741 required ISOs/RTOs to establish minimum participation criteria ensuring that each market participant has adequate risk management capabilities and adequate capital to engage in trading with minimal risk, and related costs, to the market as a whole.
- ♦ NYISO submitted a compliance filing on June 30, 2011 to establish such minimum participation criteria and to require each market participant to annually certify compliance with NYISO's minimum participation criteria.

Background

- ◆ In its ruling regarding NYISO's compliance filing (docket ER11-3949-000), FERC conditionally accepted NYISO's proposed tariff revisions, subject to a compliance filing providing for verification of Market Participant risk management procedures (§47, pg. 16):
 - *"a market participant officer-certified form that attests to the existence of risk management policies and procedures, as NYISO proposes, does not by itself satisfy... without independent verification that risk management policies and procedures are actually being implemented."*
 - *"minimum participation criteria require NYISO to engage in periodic compliance verification to minimize risk to the market."*

Background

- ◆ FERC directed NYISO to make a compliance filing, within 90 days from the date of the order (*i.e.* December 14, 2011), to establish such verification as a part of its minimum participation criteria.
 - *FERC did not mandate a particular form of periodic verification of attestations concerning risk management policies, practices and procedures.*
 - *FERC did, however, provide guidance on acceptable verification processes, indicating that a periodic verification could include:*
 - periodic review of risk management polices, practices and procedures, and their implementation, conducted on a random basis
or
 - periodic review of risk management polices, practices and procedures, and their implementation directed to certain market participants based on identified risk.

Background

- ◆ NYISO and several other ISOs/RTOs have initiated proposals indicating which subset of Market Participants would be potentially subject to verification of risk management procedures.
 - *All proposals focus primarily on a subset of Market Participants in the TCC (FTR or CRR) markets.*
- ◆ Summaries of the various ISO/RTO proposals are listed on the following slides.

Summary of ISO/RTO Proposals

| <u>ISO/RTO</u> | <u>Status</u> | <u>Verification Proposal</u> |
|----------------|---|--|
| CAISO | Approved by CAISO Board of Directors on July 14, 2011 | <ul style="list-style-type: none"> All CRR holders must submit narrative responses detailing their risk management policies applicable to CRR activities as part of annual officer certification. CRR holders with portfolios that meet two criteria below are also subject to mandatory verification: <ol style="list-style-type: none"> 1. Net portfolio value < \$200,000 during past 12 months; and 2. Ratio absolute value positive CRRs to absolute value of negative CRRs < 2. Exemption from mandatory verification for pure hedgers and CRR holders that receive CRRs only through CAISO's allocation process. CAISO will review documentation to verify that it broadly conforms to generally accepted standards for entities trading in CRR-type markets. CAISO may require any CRR holder to submit its risk management procedures applicable to CRR activities for review by CAISO at any time. |

Summary of ISO/RTO Proposals

| <u>ISO/RTO</u> | <u>Status</u> | <u>Verification Proposal</u> |
|----------------|----------------------------------|---|
| ISO-NE | Stakeholder discussions underway | <ul style="list-style-type: none"> • Require all customers transacting in the FTR market to submit risk management procedures applicable to participation in the FTR market. • Submittal required annually. • Customers not submitting by annual deadline will be suspended from FTR market. • ISO or designee (third party) to assess a subset of FTR customer's procedures. • Subset based upon volumetric threshold. • FTR customers with FTR ownership level of greater than 1,000 MWs/mo in any currently open month will be assessed. • ISO reserves the right to also assess any other FTR market participant's procedures. |
| MISO | Stakeholder discussions underway | <ul style="list-style-type: none"> • Have met several times with stakeholders and created a task team to address the issues. • Task team is actively working on criteria for requesting policies (i.e. FTR participants who do not hedge). |

Summary of ISO/RTO Proposals

| <u>ISO/RTO</u> | <u>Status</u> | <u>Verification Proposal</u> |
|----------------|--|---|
| PJM | FERC conditionally accepted subject to compliance filing in December 2011. | <ul style="list-style-type: none">• FTR participants solely hedging need only to certify they have risk management procedures. PJM may, at any time, request the FTR participant to provide additional information demonstrating hedging only activity. If request not satisfied, PJM may require FTR participant to submit risk management policies.• FTR participants speculating must submit risk management policies along with a \$1,000 one-time review fee. PJM will verify that policy generally conforms to prudent best practices relating to risk management in FTR-type markets.• Verification of procedures may occur annually.• FERC found that PJM's proposal to distinguish between FTR participants who solely hedge congestion risk related to physical transactions as a load serving entity or generation provider and other FTR participants, for purposes of risk management and verification, is reasonable but must submit a compliance filing to clarify what it means to "solely hedge." |

NYISO Proposals

- ◆ In the August 18, 2011 CPWG meeting, initial proposals were discussed regarding which subset of Market Participants would be required for verification of risk management policies & procedures:

| <u>Proposal:</u> | <u># of Active MPs:</u> | <u># of Authorized MPs not Currently Active:</u> | <u>Total # of MPs:</u> |
|--|-----------------------------|--|----------------------------|
| <ul style="list-style-type: none"> • Do not solely own grandfathered rights and/or fixed price TCCs, and • With a concentration of negative or low-positive TCCs since 2009. | 29 | 26 | 55 |
| <ul style="list-style-type: none"> • Has <\$5M in tangible net worth, • Has <5 or more years expertise in the TCC or similar market, and • Has not had a late payment to NYISO within the last 5 years. | 33* | 0 | 33 |
| <p>* NOTE: NYISO does not have audited financial statements from all Market Participants, and therefore, cannot determine the level of many Market Participants' tangible net worth. The number of Market Participants included in this table represents all Market Participants that NYISO could not explicitly confirm hold > \$5M in tangible net worth.</p> | | | |

NYISO Proposals

- ◆ At the August 18, 2011 CPWG meeting, Market Participants requested NYISO to consider developing a hybrid of the two proposals discussed at that meeting.
- ◆ A potential hybrid proposal with number of affected Market Participants is shown below:

| <u>Proposal:</u> | <u># of Active MPs:</u> | <u># of Authorized MPs not Currently Active:</u> | <u>Total # of MPs:</u> |
|---|-------------------------|--|------------------------|
| <ul style="list-style-type: none"> Do not solely own grandfathered rights and/or fixed price TCCs, Has less than \$1M in tangible net worth and less than 3 years experience in the TCC or similar market | 28* | 0 | 28 |

* NOTE: NYISO does not have audited financial statements from all Market Participants, and therefore, cannot determine the level of many Market Participants' tangible net worth. The number of Market Participants included in this table represents all Market Participants that NYISO could not explicitly confirm hold > \$1M in tangible net worth.

NYISO Final Proposal

- ♦ The NYISO slightly changed its hybrid proposal to also exclude those Market Participants who have \$10M in assets and 3 years experience in the TCC or similar market.
- ♦ Since the September 29, 2011 meeting, 7 Market Participants withdrew from the TCC market.
- ♦ The number of currently affected Market Participants is shown below:

| <u>Proposal:</u> | <u># of Active MPs:</u> | <u># of Authorized MPs not Currently Active:</u> | <u>Total # of MPs:</u> |
|--|-----------------------------|--|----------------------------|
| <ul style="list-style-type: none"> Do not solely own grandfathered rights and/or fixed price TCCs, Have a concentration of negative or low-positive TCCs since 2009, Has less than \$10M in assets or less than \$1M in tangible net worth and Has less than 3 years experience in the TCC or similar market | 19* | 0 | 19 |

* NOTE: NYISO does not have audited financial statements from all Market Participants, and therefore, cannot determine the level of many Market Participants' tangible net worth or total assets. The number of Market Participants included in this table represents all Market Participants that NYISO could not explicitly confirm hold >\$10M in assets or > \$1M in tangible net worth.

Verification Process: Standards

- ◆ The Committee of Chief Risk Officers (CCRO) has developed a Working Group for Risk Management Standards within ISO Markets.
 - *Objective is to provide an independent, industry-driven development platform for codifying minimum risk management practices, publish documentation, and provide mechanisms to support the certification of these practices within the companies participating in ISOs/RTOs.*
 - *Standards developed by this working group could subsequently be utilized across all ISOs/RTOs, thereby ensuring consistency.*
 - *NYISO and all other ISOs/RTOs are members of the working group and are participating in discussions to develop such standards.*
 - *Market Participants are encouraged to participate in the working group and can sign up utilizing the CCRO's website at www.ccro.org.*
 - Conference calls are weekly on Thursdays at 4 pm EST.

Verification Process: Standards

- ◆ The Committee of Chief Risk Officers (CCRO) has developed a Working Group for Risk Management Standards within ISO Markets.
 - *During October, working group members were provided a risk management standards survey which is intended to be a vehicle to develop minimum standards for risk management.*
 - *The working group's objectives are as follows:*
 - Review input from the questionnaire.
 - Develop recommended path forward with respect to the standard.
 - Determine an acceptable path forward.
 - Begin drafting the recommended standard at a high level.
 - *The survey is still open for Market Participant feedback.*
 - *Discussions will continue each Thursday at 4 pm EST.*

Verification Process: Overview

- ◆ Upon development of the risk management standards, NYISO and the other ISOs/RTOs will initiate verification of Market Participant risk management policies/practices (for applicable Market Participants) as required by FERC's September 15, 2011 Order:
 - *One option is to rely on an independent body such as CME or other exchanges/rating agencies to perform the verification function across all ISOs/RTOs, thereby providing consistency for Market Participants that trade in more than one ISO/RTO.*
 - The ISOs/RTOs are considering sending out a joint RFP to multiple vendors.
 - *The NYISO proposes verification of risk management procedures would begin during Q2 2012.*
 - *Cost is being evaluated and cost to participants will be discussed at future CPWG meetings.*
 - *ISOs/RTOs are seeking to standardize the verification process to the extent possible.*

Next Steps

- ◆ Continue to work with other ISOs/RTOs and CCRO to develop appropriate risk management standards.
- ◆ Determine appropriate entity to perform verification of risk management policies, practices and procedures across the ISO/RTO community.
- ◆ Continue discussions with Market Participants at future Credit Policy Working Group Meetings.
 - *November 18, 2011*
 - *December 6, 2011*
- ◆ Compliance filing due to FERC by December 14, 2011.
 - *Filing will include the following:*
 - Subset of Market Participants to be evaluated.
 - 6 to 10 high-level risk management standards.



The New York Independent System Operator (NYISO) is a not-for-profit corporation that began operations in 1999. The NYISO operates New York's bulk electricity grid, administers the state's wholesale electricity markets, and provides comprehensive reliability planning for the state's bulk electricity system.

www.nyiso.com