

# Verification/Evaluation of Market Participant Risk Management Procedures

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# Background

- ◆ The enactment of Dodd-Frank raises the question of CFTC jurisdiction over ISOs/RTOs and transactions, particularly transactions which can be characterized as “purely financial” and/or subject to speculative trading.
- ◆ Dodd-Frank provides the CFTC with the ability to exempt from its jurisdiction transactions regulated by FERC if the exemption is consistent with the public interest and the purposes of the Commodity Exchange Act (4(c)(6) exemption).

# Background

- ◆ CFTC senior staff have emphasized the importance of ensuring that ISOs/RTOs and their Market Participants have appropriate risk management policies and procedures in light of the size/scope of the trading.
- ◆ CFTC senior staff have clarified that such “verification” of risk management of ISO/RTO members requires more than simply self-certification.

# Background

- ◆ FERC senior staff have advised that it is “indefensible not to have some level of verification” and that verification is within the scope of FERC Order 741.
- ◆ Verification of the risk management policies and procedures of TCC/FTR holders may satisfy both the CFTC and FERC.

# Background

- ◆ In its June 30, 2011 compliance filing on FERC Order 741, which required ISOs/RTOs to develop criteria to ensure that each market participant has adequate risk management capabilities, NYISO stated:
  - The NYISO is working to secure an exemption pursuant to Section 4(c)(6) of the Commodity Exchange Act from all provisions of that Act and all of the Commodity Futures Trading Commission's ("CFTC's") regulations thereunder, except for those granting the authority to address fraud and manipulation. In response to concerns expressed by the CFTC regarding risk management practices, the NYISO plans to work with market participants to enhance the risk management provisions described above so as to require, in appropriate circumstances, submission and verification of an entity's risk management procedures. The NYISO may supplement this filing, as appropriate, after undertaking these discussions with market participants.
- ◆ FERC senior staff have suggested NYISO and the other ISOs/RTOs who have not already done so, submit a supplemental compliance filing regarding verification of Market Participant risk management procedures.

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



# Summary of ISO Proposals

<u>ISO/RTO</u>	<u>Status</u>	<u>Verification Proposal</u>
ISO-NE	Stakeholder discussions underway	<ul style="list-style-type: none"> <li>Require all customers transacting in the FTR market to submit risk management procedures applicable to participation in the FTR market.</li> <li>Submittal required annually.</li> <li>Customers not submitting by annual deadline will be suspended from FTR market.</li> <li>ISO or designee (third party) to assess a subset of FTR customer's procedures.</li> <li>Subset based upon volumetric threshold.</li> <li>FTR customers with FTR ownership level of greater than xxx MWs/mo in any currently open month will be assessed.</li> <li>ISO reserves the right to also assess any other FTR market participant's procedures.</li> <li>Meant to be a cooperative process between designated assessment entity, the ISO, and customer to identify and resolve gaps in risk procedures.</li> <li>If after 55 calendar days gaps remain ISO may seek to suspend FTR market access for customer.</li> </ul>

# Summary of ISO Proposals

<u>ISO/RTO</u>	<u>Status</u>	<u>Verification Proposal</u>
MISO	Stakeholder discussions underway	<ul style="list-style-type: none"> <li>TBD</li> </ul>
PJM	Included in PJM's FERC Order 741 filing.	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> <li>Verification of procedures may occur annually.</li> </ul>



# NYISO Analysis

- ◆ Similar to other ISOs/RTOs, the NYISO analyzed data relating to those Market Participants in the TCC market.
  - *There are currently 71 Market Participants authorized to participate in the TCC market.*
  - *Of those 71, there are 45 Market Participants currently holding TCCs (actively receiving from and/or paying congestion rents to the NYISO).*
  - *Of those 45, 11 Market Participants have grandfathered rights and/or fixed-price TCCs.*
    - Such Market Participants are not actively trading in TCC auctions, and therefore do not pose risk in the TCC market.
    - The CFTC would doubtfully find it necessary to verify risk management procedures for these Market Participants.

# NYISO Analysis

- ◆ Of the remaining 34 Market Participants active in the TCC market, NYISO analyzed recent trends to determine which Market Participants have portfolios with negative or low-positive concentrations.
  - *29 MPs had congestion rents since January 2009 that in a given month were either a) due to NYISO or b) were paid < \$50K.*
  - *The remaining 5 MPs consistently received congestion rents from NYISO > \$50K, indicating a concentration of high-positive TCCs.*
- ◆ Statistics Summary:
  - *71 MPs authorized to participate in the TCC market.*
  - *(26) MPs not currently active in TCC market.*
  - *(11) MPs with grandfathered rights and/or fixed-price TCCs.*
  - *(5) MPs with high-positive concentrations of TCCs.*
  - *29 MPs currently active in TCC market with concentration in negative or low-positive TCCs since 2009.*

# NYISO Proposal

- ◆ The NYISO suggests limiting assessment/verification of risk management procedures to the following subset of Market Participants, which arguably pose the most risk in the TCC market:
  - *Currently active,*
  - *Do not solely own grandfathered rights and/or fixed price TCCs,*
  - *With a concentration of negative or low-positive TCCs since 2009.*
- ◆ In addition, any new or non-active Market Participant requesting authorization to participate in the TCC market would be subject to assessment/verification of risk management procedures.

# NYISO Proposal

- ◆ How risk management policies will be verified and by whom:
  - *Could rely on an independent body such as CME to develop objective standards for risk management policies as well as evaluate the Market Participant's policies across all ISOs/RTOs.*
  - *The NYISO supports using one third-party vendor to perform verification of risk management procedures for all ISOs/RTOs in order to lessen the burden on ISOs/RTOs and on Market Participants that trade in more than one ISO/RTO.*
    - Would provide consistency for Market Participants across ISOs/RTOs and avoid Market Participants having to go through verification in multiple ISOs/RTOs.
  - *The NYISO and other ISOs/RTOs have had preliminary discussions with CME and should have additional information for Market Participants within the next month.*

# NYISO Proposal

## ◆ Timing

- *In order to secure an exemption from CFTC regulation, NYISO needs to implement a risk management verification process.*
- *CFTC action on the joint ISO/RTO request for an exemption from CFTC regulation is expected in Q4 2011 or Q1 2012.*
- *In order to assure the CFTC that this perceived “risk management gap” is filled, the NYISO needs to file a verification proposal in Q4 2011.*
- *Toward that end, NYISO seeks input from stakeholders to develop a verification process.*

# Next Steps

- ◆ Market Participant feedback should be emailed to [sprevratil@nyiso.com](mailto:sprevratil@nyiso.com) by August 31, 2011.
- ◆ Determine appropriate entity (e.g., CME) to develop objective standards and verification procedures across the ISO/RTO community.
- ◆ Continue discussions with Market Participants at future Credit Policy Working Group Meetings.
  - *September 15, 2011 - tentative*
  - *September 29, 2011*





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.

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