

# PRUDENTIAL FRAMEWORK REVIEW

Technical Panel  
February 14, 2017

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# Agenda

- Background
- 2016 Prudential Review Guiding Principles
- Areas of Consideration
- Review of the Acceptable Forms of Collateral
- Summary of Stakeholder Feedback
- IESO Recommendation
- Proposed Timelines

# Background

- As a condition of participating in the real-time markets, market participants who are net debtors must provide the IESO with prudential support (i.e. collateral) to mitigate credit risk.
- The Prudential Framework is designed to provide cost-effective credit risk mitigation for the IESO's wholesale electricity market.
- The Market Rules require the IESO to review the prudential framework at least once every three years.
- The last review was completed in 2013.

# 2016 Prudential Review Guiding Principles

The prudential framework review is guided by the following principles:

- The framework should strike a balance between costs/savings, risks, and fairness; and
- A transparent understanding of the credit risks borne by the market participants.

# 2016 Prudential Review

- Throughout 2016, the IESO conducted a stakeholder engagement initiative of the prudential framework.
- Participants were invited to provide comments and feedback to the IESO.
- The 2016 prudential review included all aspects of the prudential framework for the real-time market and the Demand Response (DR) market.

# Areas of Consideration

The 2016 review has culminated into three main components as follows:

- Surety bonds
- Stakeholder feedback
- Recommended rule amendments

# Review of the Acceptable Forms of Collateral

## Surety Bonds

- During the 2013 prudential review the IESO expressed a willingness to explore further whether a structure/form for the surety bond would be able to meet the IESO's requirements.
- The IESO engaged external legal, non-legal advisors, and other ISOs to provide counsel on surety bonds.
- The IESO continues to have material concerns with the construct of surety bonds and the IESO's ability to seek a payment on demand.
- The IESO has concluded that surety bonds are not an acceptable form of collateral.

# Summary of Stakeholder Feedback

- Feedback was received to increase the reductions allowed for Good Payment History (GPH) which would bring it in line with those provided for credit ratings.
  - The IESO does not support a framework where GPH collateral reductions should be similar to any third-party credit rating reductions.
  - This would overlook the inherently greater credit risks that the historical looking GPH has over the more robust, forward-looking credit ratings process.



# Summary of Stakeholder Feedback

- Feedback was received from the distribution community in support of the submission by the MEARIE Group to establish a pool of LDCs and the largest single LDC exposure would determine how much collateral would be provided to the IESO.
  - After assessing the merits, the IESO has determined that the MEARIE Group's concept is not aligned with the Prudential Framework's primary objectives.
  - The IESO also believes that adopting such a concept would transfer the Prudential Framework's costs/risks towards non-LDCs and to those LDCs that may not join the MEARIE Pool.

# Summary of Stakeholder Feedback

- Feedback was received from AMPCO to increase the program risk in order to reduce the program costs.
  - The IESO conducts a regular review of the Prudential Framework every three years to ensure it continues to meet the objectives of the framework which includes balancing the costs of providing prudential support versus residual credit risks.
  - The IESO has determined that the current expected default rates are generally aligned with those established during the 2013 review and therefore, no action is recommended for 2016.

# Summary of Stakeholder Feedback

- Feedback was received from AMPCO to not require collateral associated with demand response from market participants that satisfied the prudential requirements associated with the energy market.
  - The demand response (DR) pre-auction deposit amount is primarily intended to deter the gaming of the auction and to create an incentive to expeditiously complete any remaining required steps to be ready for demand response on Day 1 of the commitment period.
  - The existing Prudential Framework for the physical market was not designed to account for any defaults that might occur with respect to the DR market.

# IESO Recommendation

- The IESO is recommending minor market rule changes:
  1. Provide greater demand response (DR) prudential reductions to distributors for credit ratings and good payment history;
  2. Eliminate the requirement that the IESO pay interest on cash deposits provided as prudential support; and
  3. Amendments to existing market rules to update cross references and provide true-ups related to affiliate guarantees and credit ratings.

# Proposed Timelines

Date	Activity
February 14, 2017	Technical Panel – Introductory presentation, review market rule amendment and vote to post for stakeholder comments
If TP approves posting of amendment for stakeholder comments, then	
March 21, 2017	Technical Panel – Vote to recommend for IESO Board approval
April 12, 2017	IESO Board consideration
May 5, 2017	Implementation as early as 22 days following publication of MR amendment