Market Rule Amendment Proposal

Part 1 – Market Rule Information

Identification No.:	MR-00430		
Subject:	Prudential Support Obligations		
Title:	Prudential Support – Revisions to Reductions in Demand Response Prudential Support Obligations, Interest Payments on Cash Deposits		
Nature of Proposal:	☒ Alteration	☐ Deletion	☒ Addition
Chapter:	2	Appendix:	2.3
Sections:	Chapter 2, sections 5.7.3A, 5.7.3B and 5B.5; Appendix 2.3, section 1.7		
Sub-sections proposed for amending:	Various		

Part 2 – Proposal History

Version	Reason for Issuing	Version Date
1.0	Draft for Technical Panel Review	February 7, 2017
2.0	Publish for Stakeholder Review and Comment	February 16, 2017
3.0	Submitted for Technical Panel Vote	March 14, 2017
Approved Amendment Publication Date:		
Approved Amendment Effective Date:		

PART 3 – EXPLANATION FOR PROPOSED AMENDMENT

Provide a brief description of the following:

- The reason for the proposed amendment and the impact on the *IESO-administered markets* if the amendment is not made.
- Alternative solutions considered.
- The proposed amendment, how the amendment addresses the above reason and impact of the proposed amendment on the *IESO-administered markets*.

Summary

The IESO proposes to amend the market rules to:

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. Update existing cross-references and provide true-ups related to affiliate guarantees and credit ratings.

The proposed changes are based on the 2016 Prudential Review.
Further information on the 2016 Prudential Review can be found on the IESO's website at: http://www.ieso.ca/sector-participants/engagement-initiatives/engagements/completed/2016-prudential-review.

Background

As a condition of participating in the real-time markets or conveying electricity through the IESO-controlled grid, market participants who are net debtors must provide the IESO with prudential support (i.e. collateral) to mitigate credit risk.

The Market Rules direct the IESO to pay creditors (net sellers to the market) in full on the payment date with funds received from debtors (net buyers in the market). If a debtor does not pay the amounts owed in full, the IESO then calls upon that participant's prudential support for the amount outstanding. Any differences between the prudential support held and the amount outstanding is collected from all non-defaulting market participants through the default levy process.

The prudential framework seeks to balance the cost of providing prudential support against the potential cost of a default levy. The market rules require the IESO to review the prudential framework at least once every three years (SE-23 in 2007, SE-88 in 2010, SE-107 in 2013), and this amendment proposal is the result of the 2016 stakeholdering efforts.

DR Prudential Reductions for Distributors

Under the general prudential framework, the level of prudential support required from a market participant can be reduced by a participant's credit rating or good payment history. The reductions are detailed in Chapter 2, section 5.8, and provide greater reductions for distributors, recognizing their lower risk profile versus non-distributors.

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During 2015, the IESO held stakeholder initiatives to establish the IESO's first Demand Response (DR) prudential framework, which largely mirrored the general prudential support requirements in Chapter 2. The market rules were established under MR-00416-R04. The first auction was held in December 2015, and the first market commitment period started in May 2016. The DR prudential framework currently does not provide greater reductions for distributors versus non-distributors.

In order to align the DR prudential market rules with the general prudential framework market rules, the IESO proposes to amend the DR prudential market rules to provide greater prudential reductions for distributors.

Elimination of Interest Payments on Cash Deposits

In 2004, the IESO ceased accepting cash deposits as prudential support and grandfathered those market participants with $200,000 or less in deposits.

Currently, only two market participants have cash deposits for a total of approximately $142,000. One of the remaining two has the bulk share of approximately $140,000 posted, and this market participant has not transacted in the IESO market since 2002.

Given the small amounts on deposit, and given that the IESO is not intended to provide banking-like services, the IESO proposes to amend the market rules to eliminate the requirement that the IESO pay out interest on prudential cash deposits. The two grandfathered market participants can continue to maintain their cash collateral but will no longer receive any applicable interest on their amounts.

Discussion

Chapter 2

- Revise **existing section 5B.5.1** to specify that the credit ratings and corresponding reductions in the table are for market participants "other than a distributor."
- Add **new section 5B.5.1A** to specify the credit ratings and corresponding reductions applicable to distributors only. The language and table are based on **existing section 5.8.1A** which is the section on general prudential reductions for distributors.
- Revise **existing section 5B.5.5** to specify that the years of good payment history and corresponding reductions in the table are for market participants "other than a distributor."
- Add **new section 5B.5.5A** to specify the years of good payment history and corresponding reductions applicable to distributors only. The language and table are based on **existing section 5.8.5** which is the section on general prudential reductions for distributors.
- Revise **existing section 5.7.3A** to cross reference **existing section 5B.5.1** and **new section 5B.5.1A** to ensure that where a market participant's prudential support obligation or DR

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prudential support obligation is reduced by a credit rating, the IESO shall not accept a guarantee from an affiliate of the market participant unless the applicable rating agency has stated that the two ratings are not directly linked, thus avoiding “double counting” of a credit rating. The cross reference to **existing section 5B.5.1** is a true-up of the original DR prudential framework.

- Revise **existing section 5.7.3B** to cross reference **existing sections 5.8.1A, 5B.5.1** and **new section 5B.5.1A** such that the IESO will not accept a guarantee from an affiliate of a market participant if the affiliate is also a market participant for which a credit rating reduction has been granted in either the general prudential framework or DR prudential framework, thus avoiding “double counting” of a credit rating. The cross references to **existing sections 5.8.1A** and **5B.5.1** are true-ups of the general prudential framework and DR prudential framework.

Consequential to the above amendments, add the following cross-references:

- Revise **existing section 5B.5.4** to cross reference **new section 5B.5.5A**.

- Revise **existing section 5B.5.6** to cross reference **new section 5B.5.1A**.

<u>Chapter 2 Appendix 2.3</u>

- Revise **existing section 1.7.3** to eliminate the requirement that the IESO pay interest on cash deposits provided as prudential support or on cash proceeds from the maturity of a treasury bill.

As a matter of clean-up:

- Revise **existing section 1.7** by providing clarifications on the treatment of treasury bills and cash throughout and by replacing the incorrect cross-reference to **Chapter 2, section 5.2.2.3**, with the correct cross reference to **Chapter 2, section 5.7.2.3** (treasury bills) and adding a cross reference to **Chapter 2, section 5.7.2.5** (cash).

PART 4 – PROPOSED AMENDMENT

Chapter 2

5.7 Obligation to Provide Prudential Support

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5.7.3A Where a *market participant’s prudential support obligation* is reduced pursuant to section 5.8.1~~, or~~ 5.8.1A<u>, 5B.5.1 or 5B.5.1A</u>, the *IESO* shall not accept a guarantee

from an *affiliate* of the *market participant* pursuant to section 5.7.2.4, unless the *market participant* provides a letter from the applicable major bond rating agency identified in the list referred to in section 5.8.7, stating that the two ratings are not directly linked and are stand alone ratings in relation to each other.

5.7.3B The *IESO* shall not accept a guarantee from an *affiliate* of the *market participant* pursuant to section 5.7.2.4 if the *affiliate* is also a *market participant* and has obtained a reduction of its own *prudential support obligation* pursuant to section 5.8.1, 5.8.1A, 5B.5.1 or 5B.5.1A.

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5B. Demand Response Prudential Requirements

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5B.5 Reductions in Demand Response Prudential Support Obligations

5B.5.1 Subject to section 5B.5.2, the *IESO* may reduce the *demand response prudential support obligation* of a rated *market participant*, other than a *distributor*, by an amount equal to the monetary value prescribed by the table below, resulting from a credit rating from a major bond rating agency identified in the list referred to in section 5B.5.7 issued and in effect in respect of the *demand response market participant*.

Credit Rating Category using Standard and Poor's Rating Terminology	Allowable Reduction in Prudential Support
AA- and above or equivalent	100% of the *demand response prudential support obligation* before allowable reductions
A-, A, A+ or equivalent	Greater of 90% of the *demand response prudential support obligation* before allowable reductions or $37,500,000
BBB-, BBB, BBB+ or equivalent	Greater of 65% of the *demand response prudential support obligation* before allowable reductions or $15,000,000
BB-, BB, BB+ or equivalent	Greater of 30% of the *demand response prudential support obligation* before allowable reductions or $4,500,000
Below BB- or equivalent	0

5B.5.1A Subject to section 5B.5.2, the *IESO* may reduce the *demand response prudential support obligation* of a rated *distributor* by an amount equal to the monetary value prescribed by the table below, resulting from a credit rating from a major bond rating agency identified in the list referred to in section 5B.5.7 issued and in effect in respect of the *demand response market participant*.

Credit Rating Category using Standard and Poor's Rating Terminology	**Allowable Reduction in Prudential Support**
AA- and above or equivalent	100% of the *demand response prudential support obligation* before allowable reductions
A-, A, A+ or equivalent	Greater of 95% of the *demand response prudential support obligation* before allowable reductions or $45,000,000
BBB-, BBB, BBB+ or equivalent	Greater of 80% of the *demand response prudential support obligation* before allowable reductions or $22,500,000
BB-, BB, BB+ or equivalent	Greater of 55% of the *demand response prudential support obligation* before allowable reductions or $7,500,000
Below BB- or equivalent	0

5B.5.2 Any recommendation to move a *market participant* to "credit watch negative" by any of the major bond rating agencies identified in the list referred to in section 5B.5.7, shall be deemed to automatically result in a one-notch reduction in terms of the credit rating (for example, from BBB+ to BBB) of that *market participant* for the purpose of determining the *market participant's demand response prudential support obligation*.

5B.5.3 Where a *market participant's demand response prudential support obligation* reflects a reduction by reason of the *market participant's* credit rating from a major bond agency identified in the list referred to in section 5B.5.7, the *market participant* shall advise the *IESO* in writing immediately upon the *market participant* becoming aware of either a change in or loss of the then current credit rating or the decision of the bond rating agency to place the *market participant* on "credit watch status" or equivalent.

5B.5.4 Subject to section 5B.5.6, the *IESO* may reduce the *market participant's demand response prudential support obligation* in accordance with sections 5B.5.5 or 5B.5.5A based on the *market participant's* historical good payment history in the *IESO-administered markets*, provided that the *market participant's* payment history includes no *event of default*.

5B.5.5 The *IESO* shall determine the dollar amount of any allowable reduction in the *demand response prudential support obligation* of an unrated *market participant*, other than a *distributor*, by an amount equal to the monetary value prescribed, by the table below:

Good Payment History Categories for Non-Distributors	Allowable Reduction in Prudential Support
≥6 years	Lesser of 50% of the *demand response prudential support obligation* before allowable reductions or $12,000,000
≥5 years, <6 years	Lesser of 30% of the *demand response prudential support obligation* before allowable reductions or $7,500,000
≥4, <5 years	Lesser of 25% of the *demand response prudential support obligation* before allowable reductions or $6,000,000
≥3, <4 years	Lesser of 20% of the *demand response prudential support obligation* before allowable reductions or $4,500,000
≥2, <3 years	Lesser of 15% of the *demand response prudential support obligation* before allowable reductions or $3,000,000
<2 years	0

5B.5.5A The *IESO* shall determine the dollar amount of any allowable reduction in the *demand response prudential support obligation* of an unrated *distributor* by an amount equal to the monetary value prescribed, by the table below:

Good Payment History Categories for Distributors	Allowable Reduction in Prudential Support
≥6 years	Lesser of 80% of the *demand response prudential support obligation* before allowable reductions or $14,000,000
≥5 years, <6 years	Lesser of 65% of the *demand response prudential support obligation* before allowable reductions or $9,000,000
≥4, <5 years	Lesser of 45% of the *demand response prudential support obligation* before allowable reductions or $7,500,000
≥3, <4 years	Lesser of 35% of the *demand response prudential*

	support obligation before allowable reductions or $6,000,000
≥2, <3 years	Lesser of 25% of the *demand response prudential support obligation* before allowable reductions or $4,500,000
<2 years	0

5B.5.6 The following restrictions shall apply to the provision of reductions in a *market participant's demand response prudential support obligation* as provided for under sections 5B.5.1, 5B.5.1A, and 5B.5.4:

5B.5.6.1 a *market participant* shall not be entitled to a reduction in its *demand response prudential support obligation* pursuant to section 5B.5.4 using the payment history of an *affiliate*;

5B.5.6.2 a *market participant* that has a credit rating from a major bond rating agency identified in the list referred to in section 5B.5.7 shall not be entitled to a reduction in its *demand response prudential support obligation* under section 5B.5.4; and

5B.5.6.3 a *market participant's* reduction for either a credit rating or good payment history reduction shall be reduced by the amount of any reductions already granted to the *market participant* under section 5.8.

5B.5.7 For the purposes of this chapter, the *IESO* shall establish, maintain, and *publish* a list of major bond rating agencies eligible to provide the credit ratings mentioned in this section 5B.

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Appendix 2.3 – Prudential Support

1. Additional Provisions Regarding Prudential Support

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1.7 Prudential Support by way of Cash or Treasury Bills

Where any portion of the *market participant*'s *prudential support* is in the form of ~~cash~~ treasury bills pursuant to section 5.~~2~~7.2.3 of Chapter 2, the provision of such *prudential support* shall be reflected in a written instrument that is acceptable at the sole discretion of the IESO and the following provisions shall apply:

1.7.1 any such ~~at the *market participant's* option, cash may include~~ treasury bills shall be issued by the Government of Canada~~. Any such treasury bills~~ and for *IESO* purposes shall be valued at their current market value from time to time less two (2%) percent to take into account the potential eroding effects of interest rate increases on the value of such treasury bills;

1.7.2 the *IESO* shall retain the services of a custodian which shall retain the ~~cash or~~ treasury bills as agent for the *IESO* and not the *market participant*; and

1.7.3 ~~the *IESO* shall direct the custodian to deposit cash with a bank to which the Bank Act (Canada) applies. There shall be added to the *market participant*'s *prudential support* any and all interest earned on the cash so deposited or accretion amount(s) received in respect of the treasury bills.~~ any interest income paid by the treasury bill shall be apportioned to the benefit of the *market participant's prudential support*.

The *IESO* shall have no obligation to pay interest on the cash proceeds from the maturity of a treasury bill, or on any cash deposit held by the *IESO* in accordance with section 5.7.2.5 of Chapter 2.

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PART 5 – IESO BOARD DECISION RATIONALE

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