

Financial Assurance Credit Rule Compliance based on Order 741 *effective October 1, 2011*

WebEx broadcast
September 15, 2011

Market Participant Disclaimer

ISO New England (ISO) provides training to advance participant and stakeholder understanding.

Since not all issues and requirements are addressed by the training, participants and other stakeholders should not rely solely on this training for information but should consult the effective *Markets, Services and Transmission Tariff* ("Tariff") and the relevant *Market Manuals, Operating Procedures and Planning Procedures* ("Procedures").

In case of a discrepancy between training provided by ISO and the Tariff or Procedures, the meaning of the Tariff and Procedures shall govern.

Customer Support



- Phone: 413-540-4220
 - Recorded/monitored conversations
- Ask ISO
 - Self-service interface for submitting inquiries
 - Accessible through the SMD Applications Homepage
 - Requires a valid digital certificate with the role of *Ask ISO/External User*
 - Contact your Security Administrator for assistance
- Email: custserv@iso-ne.com
- Fax: 413-535-4156
 - **Regular Business Hours**
 - Monday through Friday, 7:30 A.M. to 5:30 P.M. Eastern Time

Objective

After this presentation, you will

- Be aware of changes to the Financial Assurance Policy based on Orders 741 and 741a
- Know what changes will be effective October 1, 2011

Commonly Used Terms

- **Commission** - Federal Energy Regulatory Commission (FERC)
- **Credit Ruling** - Requirements issued by FERC that the ISO must incorporate into its tariff via a compliance filing MAC – Material Adverse Change
- **FAP**- Financial Assurance Policy
- **NOPR** - Notice of Proposed Rulemaking
- **Rehearing** – A request that FERC re-evaluate it's initial credit ruling

Topics to be Covered

What's NOT
changing
October 1,
2011

Use of
Unsecured
Credit

Grace Period to
"Cure"
Collateral
Posting

Use of Material
Adverse
Change

Minimum
Criteria for
Market
Participation

- Shortening the Settlement Cycle
- Eliminate Unsecured Credit for Financial Transmission Rights (FTR)
- Disallow Netting between FTR and Non-FTR Requirements
- May 1, 2012 Compliance

What's not changing on October 1, 2011

Use of Unsecured Credit

Grace Period to "Cure" Collateral Posting

Use of Material Adverse Change

Minimum Criteria for Market Participation

Shortening the Settlement Cycle

Credit Ruling ¶ 32

“the Commission adopts the NOPR proposal to direct each ISO and RTO to submit a compliance filing that includes tariff revisions to establish billing periods of no more than seven days and settlement periods of no more than seven days after issuance of bills.”

- **Key Requirements**

- Must invoice no less frequently than weekly
- Payment due dates must extend no longer than seven days after bill issuance

- **Is the ISO currently compliant?**

- YES
- Billing is performed twice per week for hourly markets (generally Monday and Wednesday) with non-hourly markets being included on the first Monday bill that follows the 10th of the month
- Payment grace periods are generally end of business on the second business day after bill issuance

Eliminate Unsecured Credit for FTRs

Credit Ruling ¶75:

“the Commission directs each ISO and RTO to submit a compliance filing that includes tariff revisions to eliminate the use of unsecured credit in its FTR, or FTR equivalent markets.”

Credit Ruling ¶79:

“Additionally, the Final Rule does not provide exemptions for holders of “fixed price TCCs,” or other products, from the prohibition on the use of unsecured credit in this market as they may vary in value despite being called “fixed price.”

- **Key Requirements**

- Require that all FTR-related credit requirements be met only through the use of cash or letter of credit

- **Is the ISO currently compliant?**

- YES
- Unsecured credit is not permitted for meeting FTR-related financial assurance requirements

Disallow Netting Between FTR and Non-FTR Financial Assurance Requirements

Credit Ruling ¶78:

“The Commission also disagrees with the assertion of CAISO and Mid-American that “netting” of credit requirements between FTR and non-FTR activity should be allowed. Intermingling credit for these distinctly different markets would defeat the purpose of the Commission’s attempt to reduce market-disrupting risk.”

- **Key Requirements**

- Do not permit financial assurance credits accruing as a result of other market activity to offset the participant’s collateral requirements attributable to FTR market activity

- **Is the ISO currently compliant?**

- YES
- The ISO has established a standalone FTR credit test percentage that is not influenced by credits and/or obligations accruing as a result of a participant’s activity in any other market

Compliance Required by May 1, 2012

Credit Ruling ¶117:

“The Commission directs each ISO and RTO to submit a compliance filing that includes tariff revisions to include one of the following options:

- Establish a central counterparty as discussed above.
- Require market participants to provide a security interest in their transactions in order to establish collateral requirements based on net exposure.
- Propose another alternative, which provides the same degree of protection as the two above-mentioned methods.
- Choose none of the three above alternatives, and instead establish credit requirements for market participants based on their gross obligations.”

- How will ISO be compliant?
 - Assuming that the ISO obtains an IRS Determination letter stating that the ISO’s 501 (c) (3) status will not be affected, the ISO will take to the stakeholder process a proposal to make the ISO a central counterparty

What's not
changing on
October 1,
2011

**Use of
Unsecured
Credit**

- Credit Rule Rehearing
- Individual & Corporate Family Caps
- Example: \$50 Million Corporate Family Cap

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Use of Unsecured Credit

Credit Rule Rehearing

Credit Ruling Rehearing ¶19:

“The Commission therefore grants rehearing and finds that the limit on the use of unsecured credit should be no more than **\$50 million per entity, including the corporate family** to which an entity belongs.”

Individual and Corporate Family Caps

Credit Limit Caps

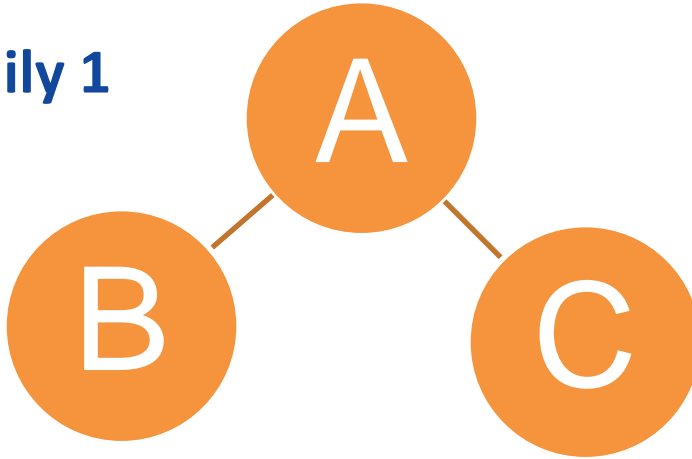
- | | |
|--|--|
| <ul style="list-style-type: none">• Individual Cap (Non-Municipal Market Participants and Non-Market Participant Transmission Customers)*<ul style="list-style-type: none">• \$50 million Market Credit Limit• \$50 million Transmission Credit Limit | <ul style="list-style-type: none">• Corporate Family Cap (all customer types)<ul style="list-style-type: none">• \$50 million Market Credit Limit• \$50 million Transmission Credit Limit |
|--|--|

***Note:** Municipal Market Participant individual caps have not changed and remain at \$25 million for market charges and \$25 million for transmission charges

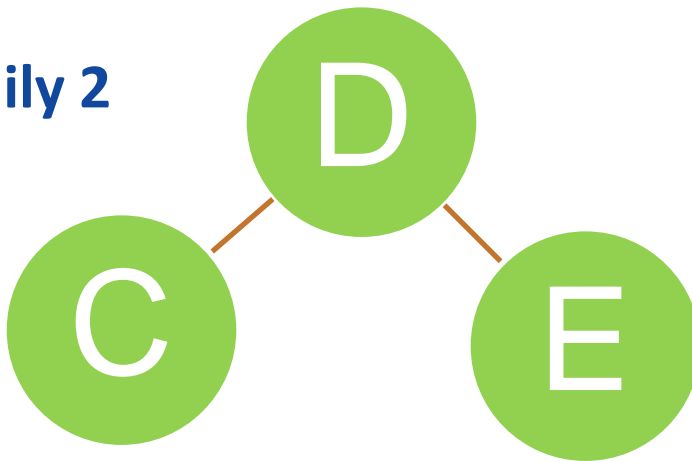
\$50 Million Corporate Family Cap

Example

- **Family 1**



- **Family 2**



\$50 Million Corporate Family Cap (cont.)

Example

Before applying \$50 M Corporate Family Cap				
Company A	Company B*	Company C	Company D	Company E
<ul style="list-style-type: none">• MCL = \$25M• TCL = \$25M• Total= \$50M	<ul style="list-style-type: none">• MCL = \$0M• TCL = \$0M• Total= \$0M	<ul style="list-style-type: none">• MCL = \$25M• TCL = \$25M• Total= \$50M	<ul style="list-style-type: none">• MCL = \$25M• TCL = \$25M• Total= \$50M	<ul style="list-style-type: none">• MCL = \$25M• TCL = \$25M• Total= \$50M

- MCL = Market Credit Limit
- TCL = Transmission Credit Limit

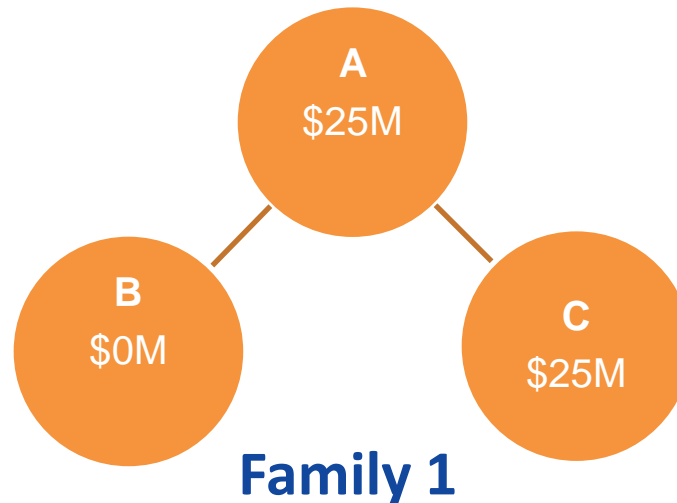
*Company B opted out of having Market and Transmission Credit Limits

Note: In this example the customer did not specify credit limits

\$50 Million Corporate Family Cap (cont.)

Example

After applying \$50M Corporate Family Cap (Family 1)

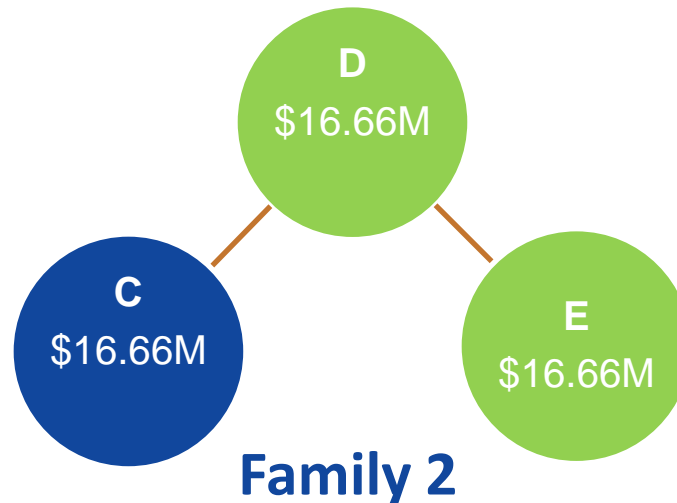


- Companies A and C had individual credit limits of \$50M each
- As such, the credit limits were reduced on a pro-rated basis to \$25M (\$12.5M Market Credit Limit; \$12.5M Transmission Credit Limit) to maintain compliance with the Corporate Family Cap of \$50M

\$50 Million Corporate Family Cap (cont.)

Example

After applying \$50M Corporate Family Cap (Family 2)

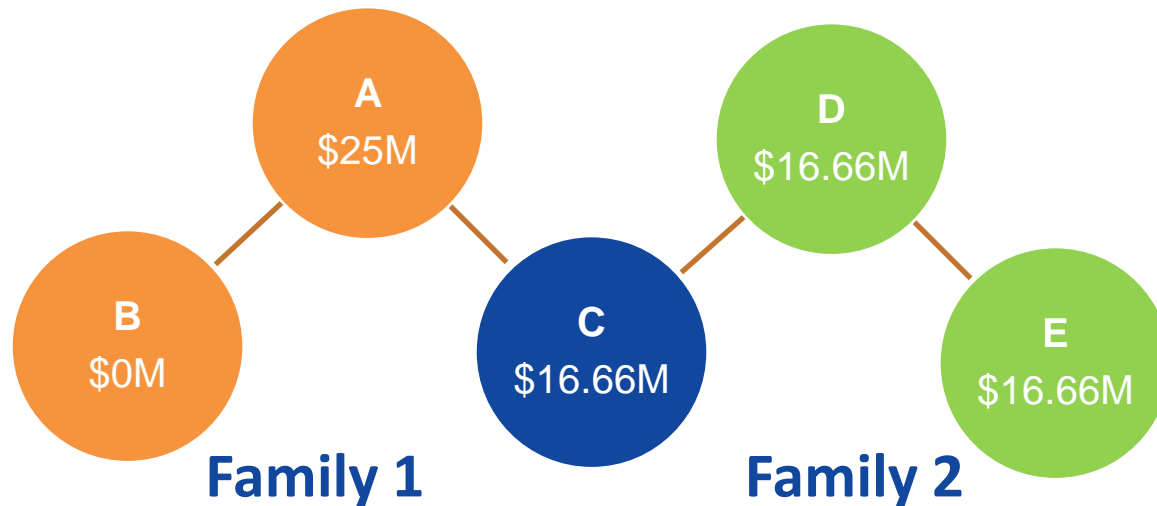


- Companies C, D, and E had individual credit limits of \$50M each
- As such, the credit limits were reduced on a pro-rated basis to \$16.66M (\$8.33M Market Credit Limit; \$8.33M Transmission Credit Limit) to maintain compliance with the Corporate Family Cap of \$50M

\$50 Million Corporate Family Cap (cont.)

Example

After applying \$50M Corporate Family Cap (Family 1 & Family 2)



- Company C is affiliated with both Family 1 and Family 2
- As such, Company C is constrained by \$16.66M, the value which keeps both of its families in compliance with the \$50M Corporate Family Cap

\$50 Million Corporate Family Cap (cont.)

Example

- How can I ensure that members of Family 1 are afforded credit limits totaling the \$50M Corporate Family Cap?

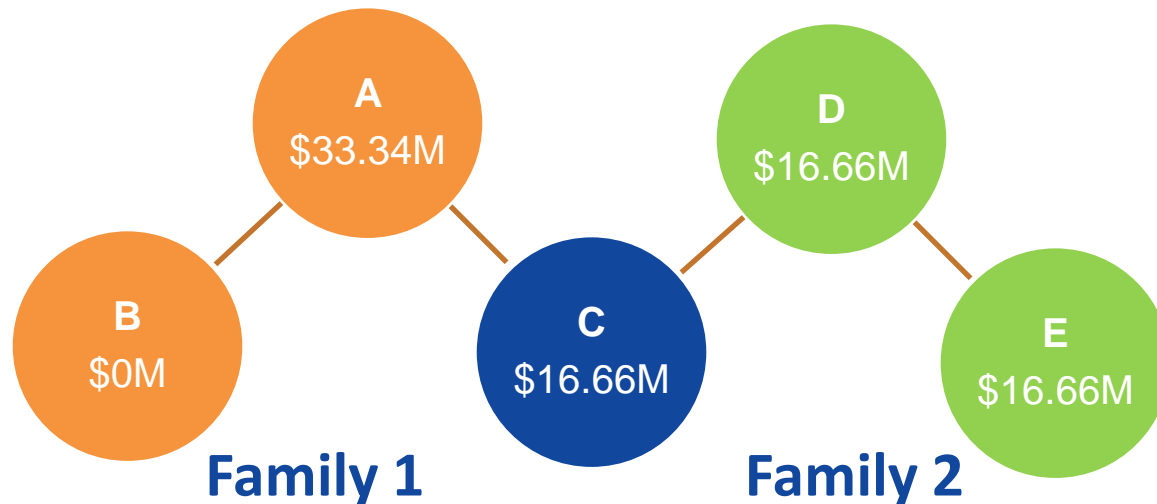
FA contacts of Non-Municipal Market Participants and Non-Market Participant Transmission Customers may designate Market Credit Limit and Transmission Credit Limit values for up to four future calendar quarters by sending such designations to custserv@iso-ne.com so that a ticket can be created

- Value must be received no later than five business days prior to the start of the applicable quarter or five business days after an affiliate change
- Value is not to exceed
 - \$50 million Market Credit Limit
 - \$50 million Transmission Credit Limit
 - \$50 million in total

\$50 Million Corporate Family Cap (cont.)

Example

After customer specification of credit limits



- Company C is affiliated with both Family 1 and Family 2
- As such, Company C is constrained by \$16.66M, the value which keeps both of its families in compliance with the \$50M Corporate Family Cap

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Grace Period Cure Details

Credit Ruling ¶117:

“The Commission adopts the NOPR proposal to require each ISO and RTO to include in the credit provisions of its tariff language to limit the time period allowed to post additional collateral. In addition, we require each ISO and RTO to allow no more than two days to “cure” a collateral call. The Commission directs each ISO and RTO to submit a compliance filing that includes tariff revisions to establish a two-day limit to post additional collateral due to invocation of a “material adverse change” clause or other provision of an ISO/RTO tariff.”

- ISO may send an *all participants notification* of a Financial Assurance Default (failure to comply with any provisions of the FAP) within two business days of failure to cure default, concurrently with notification to participant or two business days after such notification to participant

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**Use of
Material
Adverse
Change
(MAC)**

Minimum
Criteria for
Market
Participation

Credit Ruling ¶149

Use of Material Adverse Change (MAC)

“...each ISO and RTO [must] submit a compliance filing that includes tariff revisions to establish and clarify when a market administrator may invoke a “material adverse change” clause **to compel a market participant to post additional collateral, cease one or more transactions, or take other measures to restore confidence in the participant’s ability to safely transact. The tariff revisions should state** examples of which circumstances entitle a market administrator to invoke a “material adverse change” clause, but this list should be illustrative, rather than exhaustive. The **tools used to determine “material adverse change” should be sufficiently forward looking to allow the market administrator to take action prior to any adverse** effect on the market, but provide the market participants with notice as to what events could trigger a collateral call or a change in activity in the market... Other criteria, like large changes in the price for a collateralized debt security, are potentially more forward looking and would allow the ISO or RTO to request collateral before a market participant is in financial distress.”

Credit Ruling ¶151

Use of MAC

“The Commission is also sensitive to the need for a record of the market administrator’s actions when exercising this discretion. Therefore, the Commission directs the ISOs and RTOs to provide reasonable advance notice to a market participant, when feasible, when the ISOs and RTOs are compelled to invoke a “material adverse change” clause. The **notification should be in writing, contain the reasoning behind invocation of the “material adverse change” clause, and be signed by a person with authority to represent the ISO/RTO in such actions. This will allow for** a timely remedy for continued market participation, but also provide for a possible dispute to be resolved after the fact...”

Circumstances Added

Use of MAC

Two circumstances added to the *illustrative list of circumstances* which would cause the ISO to invoke a MAC

1. The sanctioning of the customer or its principals by the Commission, the Securities and Exchange Commission, the Commodity Futures Trading Commission, any exchange monitored by the National Futures Association, or any entity responsible for regulating activity in energy markets
2. A significant change in the Market Participant's or Non-Market Participant Transmission Customer's market capitalization

Ability to Request Additional Collateral

Use of MAC

- If the additional amount of financial assurance required is *equal to or greater than \$25 million*, then the Chief Financial Officer of ISO must first consult, to the extent practicable, with ISO's Chief Executive Officer, Chief Operating Officer, and General Counsel



Please submit your questions via the Q+A panel

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- Credit Rulings
- Information Disclosure
- Risk Management & Communication
- Capitalization

**Minimum
Criteria for
Market
Participation**

Credit Rulings

Credit Rulings

Minimum Criteria for Market Participant (MP)

Credit Ruling ¶123

“The Commission has always been wary of unnecessary barriers to entry to market participants, with a goal of ensuring sufficient participation, adequate liquidity, and competitive results. However, this consideration must be balanced with protecting the market from risks posed by under-capitalized participants without adequate risk management procedures in place. Having minimum criteria in place can help minimize the dangers of mutualized defaults posed by inadequately prepared or undercapitalized participants.”

Credit Ruling ¶131:

“In taking this approach, the Commission is aware that stakeholder groups with competing interests may disagree on these criteria, and so the Commission will review proposed Tariff language to ensure that it is just and reasonable and not unduly discriminatory. The Commission believes that such standards might address adequate capitalization, the ability to respond to ISO/RTO direction and expertise in risk management. The Commission directs that these criteria apply to all market participants rather than only certain participants.”

Credit Ruling (cont.)

Minimum Criteria for MP

Credit Ruling ¶131

“The Commission is persuaded that each ISO and RTO should include in its tariff language to specify minimum participation criteria to be eligible to participate in the organized wholesale electric market, such as requirements related to adequate capitalization and risk management controls. This will help protect the markets from risks posed by under-capitalized participants or those who do not have adequate risk management procedures in place. Minimum criteria for market participation could include the capability to engage in risk management or hedging or to out-source this capability with periodic compliance verification, to make sure 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.”

Credit Ruling ¶132

“However, the Commission will not specify criteria at this time, and instead directs that each ISO and RTO develop these criteria through their stakeholder processes.”

Credit Ruling (cont.)

Minimum Criteria for MP

Credit Ruling Rehearing ¶33

“Because no market participation criteria have yet to be filed, the Commission cannot determine whether such criteria are or are not reasonable. However, we note that we did not mandate a single set of criteria for all participants in a market, and we see value in Six Cities’ suggestion that stakeholders consider whether **some criteria can be tiered or calibrated based on, for example, the size of a market participant’s positions. Such an approach would allow for differentiation based on a market participant’s characteristics, but still reduce the market’s exposure to the risk of a default.**”

Information Disclosure

Information Disclosure Requirements

Submit Annually by April 30 (applicants submit when applying for membership)

Information Disclosure Requirements

List of Principals

List of any material criminal or civil litigation

List of sanctions involving the customer or applicant or any of the Principals of the customer or applicant imposed by the Federal Energy Regulatory Commission, the Securities and Exchange Commission, the Commodity Futures Trading Commission, any exchange monitored by the National Futures Association, or any state entity responsible for regulating activity in energy markets where such sanctions were either imposed in the past five years or, if imposed prior to that, are still in effect

Written summary of any bankruptcy, dissolution, merger or acquisition of the customer or applicant in the preceding five years

List of current retail and wholesale electricity market-related operations in the United States, other than in the New England markets

Information Disclosure Requirements (cont.)

Principal

- The new defined term, **Principal**, covers any person or entity that has the power to exercise a controlling influence over an organization's activities that might be relevant to an assessment of that organization's ability and qualification to participate in the New England Markets
- Transmission, Markets & Services Tariff, Section I.2.2
 - Principal: (i) the sole proprietor of a sole proprietorship; (ii) a general partner of a partnership; (iii) a president, chief executive officer, chief operating officer or chief financial officer (or equivalent position) of an organization; (iv) a manager, managing member or a member vested with the management authority for a limited liability company or limited liability partnership; (v) any person or entity that has the power to exercise a controlling influence over an organization's activities that are subject to regulation by the Federal Energy Regulatory Commission, the Securities and Exchange Commission, the Commodity Futures Trading Commission, any exchange monitored by the National Futures Association, or any state entity responsible for regulating activity in energy markets; or (vi) any person or entity that: (a) is the direct owner of 10% or more of any class of an organization's equity securities; or (b) has directly contributed 10% or more of an organization's capital.

Information Disclosure Requirements (cont.)

Submittal

- Applicants and customers may submit lists as specified **OR** as filings made to the Securities Exchange Commission (SEC) provided the information is substantially similar
 - If submitting SEC filings, the location of the required information within such filings must also be provided
 - Submitting SEC filings without the requisite location information shall have the same consequences as not submitting any information at all
 - ISO is working towards an electronic solution for customer submittal of information disclosure requirements
 - If available in 2012, it will be the required means of providing such information
 - More information on the submittal process will be available in late 2011
 - Applicants will be required to submit the information disclosure requirements electronically (via email to custserv@iso-ne.com)

Information Disclosure Requirements (cont.)

Consequences of Non-Compliance



Note: There is no cure period for applicants. Market participation will not begin until the next opportunity following the submittal of all requisite information

Information Disclosure Requirements (cont.)

Consequences of Unreasonable Risk

The ISO will review the information and determine whether the customer or applicant or any of the Principals of the customer or applicant pose an unreasonable risk or are included on any relevant list maintained by the U.S. Office of Foreign Asset Control

Information Disclosure Requirements (cont.)

Specifics for Consequences of Unreasonable Risk

- The Chief Financial Officer of the ISO will work with the Participants Committee or its delegate to develop an informed opinion with respect to the identified concerns, including any measures (including suspension) that the ISO may recommend imposing
- If the ISO chooses to impose measures other than prohibition (in the case of an applicant) or terminate (in the case of a customer) participation in the New England Markets, then the ISO shall be required to make an information filing with the Commission
- If the ISO chooses to prohibit (in the case of an applicant) or terminate (in the case of a customer) participation in the New England Markets, then the ISO must file for Commission approval of such action, and the prohibition or termination shall become effective only upon final Commission ruling

Risk Management & Communication

Risk Management & Communication

Requires Submission of a Certificate

- Due **annually** between January 1 - April 30 (applicants must submit with application)
- Certifies the following:
 - Entity has established or contracted for risk management procedures that are applicable to participation in the New England Markets
 - Entity has established or contracted for appropriate training of relevant personnel that is applicable to its participation in the New England Markets
 - Entity has established or contracted to establish procedures to effectively communicate with and respond to ISO with respect to matters relating to the FAP and the Billing Policy and that at least one person from the certifying entity has the ability and authority to address such matters on business days from 9:00 a.m. to 5:00 p.m.
- Must be signed on behalf of the customer or applicant by a Senior Officer of the customer or applicant and must be notarized
- Certificate is located at on the ISO web site: [Settlements > Financial Assurance & Credit > FA Policies & Amendments](#)

Risk Management & Communication(cont.)

- The ISO is working towards an electronic solution for submittal of the risk management and communications certificate
 - If available in 2012, it will be the required means for customers to provide such information
 - More information on the submittal process will be available by late 2011
- Applicants will be required to submit the risk management and communications certificate electronically
 - By email to custserv@iso-ne.com
- Certificate ***must also*** be mailed to the attention of the *Market & Credit Risk Department* so that the ISO may verify notarization

Risk Management & Communication (cont.)

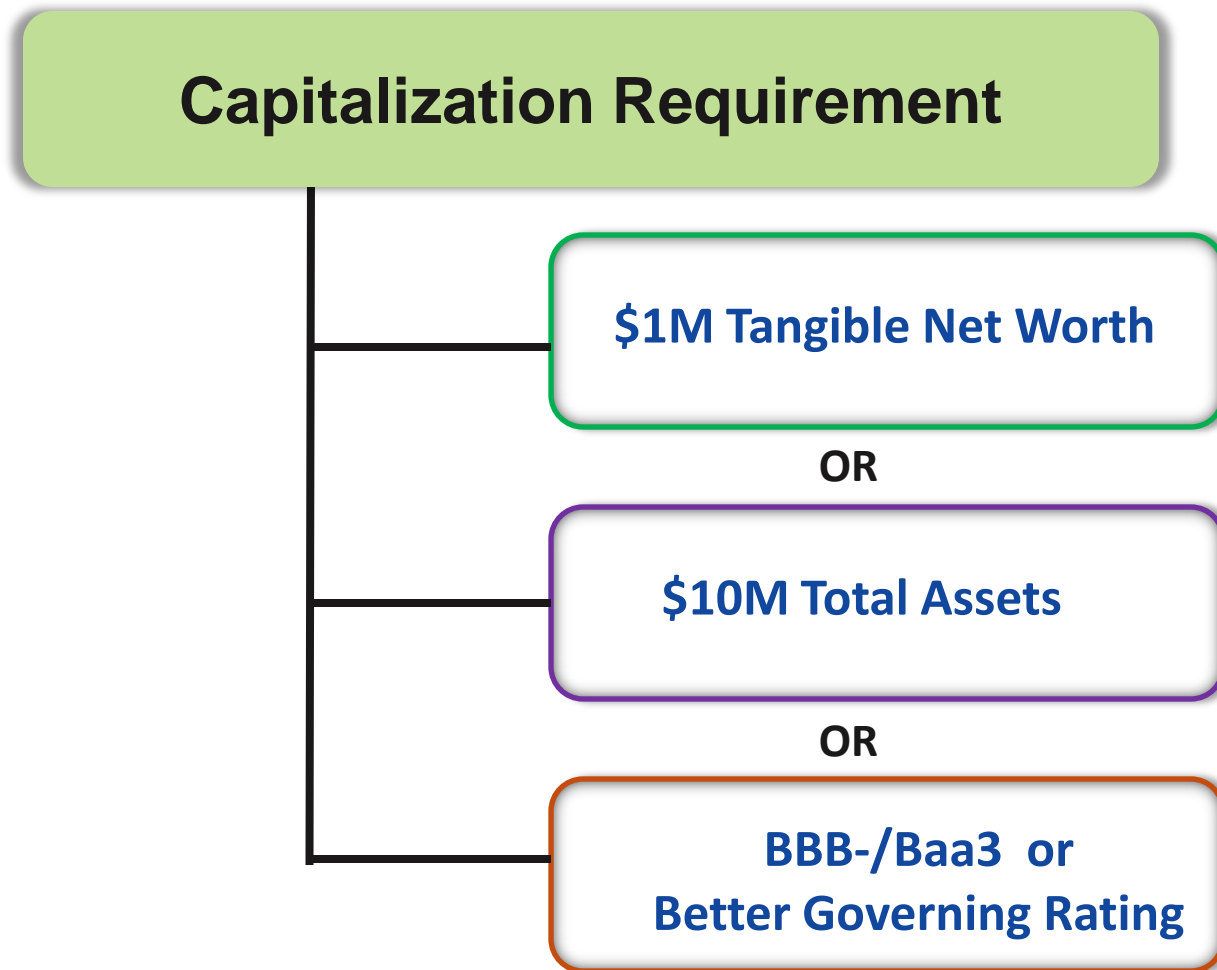
Consequences of Non-Compliance



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Capitalization

Capitalization Requirement



Capitalization Requirement (cont.)



- Financial Statements are due on a quarterly basis for all customers
 - Q1, Q2, and Q3 statements accompanied by an officer's certificate are due 55 days after each quarter ends
 - Annual audited statements are due 100 days after the year ends
- Failure to submit statements is considered a Financial Assurance Default
 - May result in notification to the NEPOOL Participants Committee, all Financial Assurance and billing contacts, and suspension or termination proceedings by the ISO

Capitalization Requirement (cont.)

Annual Audited Financial Statement Requirement

- The FAP affords the ISO discretion in accepting alternate forms of financial statements (e.g., consolidating statements of a subsidiary, compiled statements, reviewed statements)
 - Requests to submit alternate statements must be submitted in advance of the requisite due dates and allow the ISO ample time to make a determination of alternate statement acceptability
 - Amount of time needed to make an assessment will vary depending on the type of statements proposed
 - Last minute requests may result in the audited statement requirement remaining in place
- In addition to accepting statements prepared in accordance with U.S. generally accepted accounting principals, the ISO may now accept statements prepared in accordance with international accounting standards

Capitalization Requirement (cont.)

Tangible Net Worth

- Assets less the following:
 - restricted assets or assets potentially unavailable to settle a claim in the event of a default (e.g., regulatory assets, restricted assets, and Affiliate assets), net of any matching liabilities, to the extent that the result of that netting is a positive value
 - derivative assets, net of any matching liabilities, to the extent that the result of that netting is a positive value
 - liabilities
 - preferred stock
 - non-controlling interest
 - all of that entity's intangible assets (e.g., patents, trademarks, franchises, intellectual property, goodwill, and any other assets not having a physical existence), in each case as shown on the most recent financial statements provided by such entity to the ISO

Capitalization Requirement (cont.)

Total Assets



All assets as reported on an entity's balance sheet

**BBB-/Baa3 or
Better Governing
Rating**



Lowest rating assigned by S&P, Moody's, and Fitch

Capitalization Requirement (cont.)

Consequences

- Failure to meet minimum capitalization criteria:
 - Prohibited from acquiring FTRs greater than one month of duration
 - Incremental FTR FA requirement equal to 15% times current FTR FA requirement
 - Incremental capitalization FA requirement as calculated below

Total FA Requirement (excluding FTR Requirements)	Additional FA Required
\$100,000 to \$249,999	\$25,000
\$250,000 to \$499,999	\$50,000
\$500,000 to \$999,999	\$100,000
\$1,000,000 to \$9,999,999	\$200,000
\$10,000,000 or greater	\$500,000

Topics Covered

- Shortening the Settlement Cycle
- Eliminate Unsecured Credit for Financial Transmission Rights (FTR)
- Disallow Netting between FTR and Non-FTR Requirements
- May 1, 2012 Compliance

What's NOT changing October 1, 2011

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Broadcast has been paused for four minutes to allow evaluation submissions

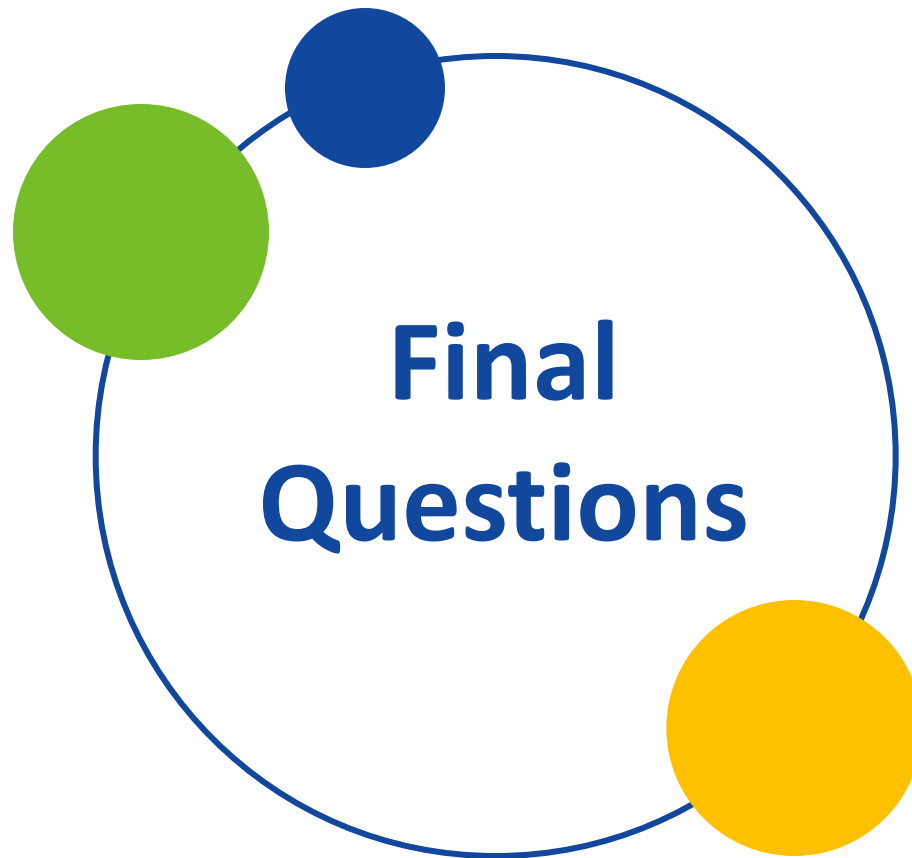
Please raise your hand  to indicate we can proceed with final Q+As



References

- ISO New England web site
 - www.iso-ne.com
- Financial Assurance Policy
 - [Settlements > Financial Assurance & Credit > FA Policies & Amendments > Section I – General Terms and Conditions](#)
- Customer Support
 - Phone: 413-540-4220
 - [Ask ISO](#): Submit and track your own inquiry
 - E-mail: custserv@iso-ne.com
- ISO New England
One Sullivan Road
Holyoke, MA 01040
Attn: Market & Credit Risk Department





Final Questions

If you have questions after the broadcast:

Customer Support at (413) 540-4220 or e-mail: custserv@iso-ne.com

WebEx broadcast for
Financial Assurance Credit Rule Compliance based on Order 741
has concluded



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