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## Market Rule Amendment Proposal

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### PART 1 – MARKET RULE INFORMATION

Identification No.:	<b>MR-00212-R00</b>		
Subject:	<b>Prudential Support</b>		
Title:	<b>Revisions to Prudential Support Obligations</b>		
Nature of Proposal:	<input checked="" type="checkbox"/> Alteration	<input type="checkbox"/> Deletion	<input type="checkbox"/> Addition
Chapter:	2	Appendix:	
Sections:	5.3		
Sub-sections proposed for amending:	5.3.8A, 5.3.8B, 5.3.10, 5.3.10A, 5.3.10B, and 5.3.11		

### PART 2 – PROPOSAL HISTORY

Version	Reason for Issuing	Version Date
1.0	Draft for Technical Panel Review	May 16, 2007
2.0	Published for Stakeholder Review and Comment	May 24, 2007
3.0	Draft for Technical Panel Vote	June 7, 2007
4.0	Recommended by Technical Panel and Submitted for IESO Board Approval	June 12, 2007
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**

This amendment proposes to modify the prudential support obligations for Market Participants in accordance with the recommendations contained within SE-23 Prudential Review Report as approved by the IESO Board at its meeting on April 26, 2007.

The specific amendments in this proposal are to:

- Obligate the IESO to establish and review its price basis used to calculate maximum net exposure on an annual basis, taking into consideration price information published by the OEB
- Obligate the IESO to modify its price basis if the underlying reference price changes by 15% or more from the previous value used by the IESO to calculate prudentials.
- Permit a metered market participant, under specified conditions, to request the IESO modify their minimum trading limit and default protection amount reflecting physical bilateral contracts registered with the IESO
- Obligate the IESO, provided the metered market participant has met specified conditions, to incorporate the impact of physical bilateral contracts which have been registered with the IESO on the calculation of the minimum trading limit and default protection amount for investment grade market participants.

All of the above amendments are contained within MR-00212-R00.

- Give the IESO discretion over the terms of a bank guarantee, and define acceptable institutions as a bank named in a Schedule to the Bank Act, or a credit union licensed by the Financial Services Commission of Ontario (FSCO), in either case having a specified minimum long-term credit rating from an IESO approved credit rating agency. (Please refer to MR-00212-R01)
- Increase the maximum amount for affiliate guarantees for both distributors and non-distributors, consistent with the revised unsecured credit limits in section 5.8. (Please refer to MR-00212-R01)
- Increase the unsecured credit limits for credit ratings and good payment history for both distributors and non-distributors. (Please refer to MR-00212-R02)

These proposed changes in this specific amendment and the related amendments MR-00212-R01-R02 will result in net savings to market participants of \$900,000 as outlined in the SE-23 Prudential Review Report.

It is also proposed to add sub-headings to improve reader understanding of this section of the market rules.

**PART 3 – EXPLANATION FOR PROPOSED AMENDMENT****Background**

In 2006, as part of the IESO's continuing efforts to reduce the financial burden to those participating in the IESO administered-markets (IAM), a review (Review) of the physical market prudential framework was initiated. The Review was undertaken to assess whether the current prudential requirements are reasonable and whether there are opportunities to reduce the prudential burden while not unduly exposing market participants to risk.

The finding of the Review is that the current prudential system requires market participants to provide more prudential support than is reasonably necessary.

At its meeting on April 26, 2007 the IESO Board:

- Approved the recommendations made in the SE-23 Prudential Review Report;
- Directed IESO Management to amend or develop market rules consistent with those recommendations for IESO Board of Director approval at their September 7, 2007 meeting;
- Directed IESO Management to amend market manuals and implement the recommendations in 2007;
- Directed IESO Management to conduct a review of the Real-time Market prudential framework at least once every three years; and
- Directed IESO Management to undertake a review of the Financial Market prudential framework as part of the Day-Ahead Market undertaking or separately as warranted.

The final report on the Review can be found on the IESO web-site at the following location:

<http://www.ieso.ca/imoweb/pubs/consult/se23/se23-20070313-Prudential-Review-Report.pdf>

In accordance with the IESO Board's approval of the recommendations contained within the SE-23 Prudential Review Report it is proposed to modify the market rules in Section 5 Chapter 2.

For further information please refer to MR-00212-Q00.

**Discussion**

In order to implement the IESO Board's policy decision on the provision of prudential support in IESO-administered markets it is proposed that the market rules be modified in the following manner:

Amend Chapter 2, section 5.3 (Calculation of Participant Trading Limit, Default Protection Amount and Maximum Net Exposure) by:

- Inserting section 5.3.8A to permit a metered market participant with a credit rating of BBB- or higher to request that their minimum trading limit and default protection amount reflect physical bilateral contracts registered with the IESO provided they submit to the IESO the quantity and duration of the applicable physical bilateral contract and that they notify the IESO immediately upon a change in the quantity or duration of the physical bilateral contract including its termination. Immediate notification is required so that the IESO can review and, if necessary adjust the market participant's minimum trading limit and default protection amount.
- Inserting section 5.3.8B to specify that provided the conditions of section 5.3.8A are met the IESO would be obligated to determine the metered market participant's prudential support obligation assuming all energy injected or withdrawn is transacted through the real-time market net of energy

**PART 3 – EXPLANATION FOR PROPOSED AMENDMENT**

quantities associated with the physical bilateral contracts but ignoring any assignments of hourly uplift components for those contracts.

These rules are a result of recommendation 7.3 in the SE-23 report.

The Report is not explicit in the application of this recommendation to metered market participants (MMPs) only because of how the prudential support obligation (PSO) calculation methodology is applied specifically to the minimum trading limit of a MMP versus a non-metered market participant (NMMP).

For a MMP, the IESO determines the minimum trading limit by estimating the net settlement amounts (total of payments owed by the MMP less any amounts owed to the MMP by the IESO) incurred in the real-time market assuming (i) 7 days of market activity and (ii) that all energy injected or withdrawn is transacted through the real-time market. This means that the impact of any physical bilateral contract or physical allocation data is NOT included in the determination of the minimum trading limit. The minimum trading limit is based on the expected energy withdrawals or injections as shown on the revenue wholesale meter.

- Whereas, for a NMMP where metered data is not available, such as a marketer, the minimum trading limit is determined as 25% of the estimated net settlement amounts for the upcoming billing period where the settlement amounts are based on the average of the three most recent billing periods. If the NMMP has a physical bilateral contract outstanding it will be reflected in those settlement amounts and thus the PSO going forward will accurately reflect the exposure to the IESO administered market. Therefore, the NMMP already experiences the benefit of reduced PSO as a result of PBC's, albeit on a lagged basis.
- Modify section 5.3.10 to include reference to the price bases derived in accordance with the proposed new section 5.3.10A. The proposed section 5.3.10A is critical to the IESO's estimation of net settlement amounts for market participants as described in section 5.3.10;
- Inserting section 5.3.10A obligating the IESO to use electricity price information published by the OEB to establish the IESO price basis for calculating the minimum trading limit and default protection amount (recommendation 5.3 – 3 of SE-23 Report);
- Inserting section 5.3.10A.1 to specify which OEB reference price the IESO should use as its price basis for a metered market participant that is not a distributor (recommendation 5.3 – 2 of SE-23 Report);
- Inserting section 5.3.10A.2 to specify which OEB reference price the IESO should use as its price basis for a metered market participant that is a distributor (recommendation 5.3 – 1 of SE-23 Report);
- Inserting section 5.3.10B to obligate the IESO to perform an annual review of the price basis used to calculate the minimum trading limit and the default protection amount. The IESO would also be obligated to modify its price basis if it has changed by 15% or more from the previous price basis used by the IESO to calculate the minimum trading limit and default protection amount (recommendation 5.3 – 4 of SE-23 Report).
- Insert section 5.3.11.5 to specify another condition under which the IESO is obligated to review a market participant's: minimum trading limit (where applicable); the trading limit; the default

**PART 3 – EXPLANATION FOR PROPOSED AMENDMENT**

protection amount; and maximum net exposure. In this case the additional condition is when the IESO has adjusted its price basis under section 5.3.10B.

Although the OEB's forecast is available semi-annually, the IESO believes an annual review is sufficient to manage the risk exposure and that less frequent reviews will save market participants administrative burden including associated costs. For the same reason, small adjustments to the price basis should also be avoided; thus, the recommendation of the 15% materiality threshold. Throughout the consultation, stakeholders expressed full support of less frequent changes to their prudential support obligation wherever possible. The IESO did not receive any written feedback to the contrary.

**PART 4 – PROPOSED AMENDMENT****5.3 Calculation of Participant Trading Limit, Default Protection Amount and Maximum Net Exposure**

5.3.1 The *IESO* shall determine, for each *market participant*, subject to section 5.6.5, a *maximum net exposure* as the sum of the *market participant's trading limit* and the *market participant's default protection amount*.

**Self-Assessed Trading Limit**

5.3.2 Subject to section 5.3.3, each *market participant* shall determine and submit to the *IESO*, using forms and procedures as may be established by the *IESO* in the applicable *market manual*, the amount of its *self-assessed trading limit* at least 7 *business days* prior to the start of any *energy market billing period*, even if that *self-assessed trading limit* is zero.

5.3.2.1 [Intentionally left blank]  
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 b. [Intentionally left blank]

5.3.2.2 [Intentionally left blank]  
 a. [Intentionally left blank]  
 b. [Intentionally left blank]

5.3.2A [Intentionally left blank]  
 5.3.2A.1 [Intentionally left blank]  
 a. [Intentionally left blank]  
 b. [Intentionally left blank]  
 5.3.2A.2 [Intentionally left blank]

- a. [Intentionally left blank]
- b. [Intentionally left blank]

5.3.2A.3 [Intentionally left blank]

5.3.3 The *self-assessed trading limit* submitted by a *market participant* under section 5.3.2 shall be applicable for all future *energy market billing periods* until a revised *self-assessed trading limit* is submitted by that *market participant* to the *IESO* in accordance with the provisions of section 5.3.2. If a *market participant* submits a *self-assessed trading limit* pursuant to section 5.3.2, that *self-assessed trading limit* shall, as of the next *energy market billing period*, supersede any previous *self-assessed trading limit*, and the previous *self-assessed trading limit* shall not be applicable to any such future *energy market billing periods*.

### Minimum Trading Limit

5.3.4 Subject to section 5.6.5, the *IESO* shall establish a *minimum trading limit* for each *market participant* as follows:

5.3.4.1 the *minimum trading limit* for a *metered market participant* shall be equal to the *IESO's* estimate of the *metered market participant's* net *settlement amounts*, excluding estimated *settlement amounts* associated with the *energy forward market* and estimated *settlement amounts* associated with a *transmission right*, assuming 7 days of participation in the *real-time market* and assuming all *energy* injected or withdrawn is transacted through the *real-time market*. The *IESO* may use a greater number, up to and including 49 days, of participation in the *real-time market* for the determination of a *metered market participant's* *minimum trading limit* if that *metered market participant* was subject to more than one *margin call* per *energy market billing period*, provided that any such *margin call* is not the result of a price spike;

- a. [Intentionally left blank]
- b. [Intentionally left blank]
- c. [Intentionally left blank]

5.3.4.2 the *minimum trading limit* for a *market participant* that is not a *metered market participant* shall be equal to 25% of the *IESO's* estimate of the *market participant's* net *settlement amounts* for the upcoming *energy market billing period*. In estimating this net *settlement amount*, the *IESO* shall, subject to section 5.3.4.3, use an average of the actual net *settlement amounts* for the 3 most recent *energy market billing periods* in which that *market participant* has transacted in the *real-time market*. The *IESO* may use a greater percentage, up to and including 100%, of the estimated *market participant's* net *settlement amounts* for the determination of a *market*

*participant's minimum trading limit* if that *market participant* was subject to more than one *margin call* per *energy market billing period*, provided that any such *margin call* is not caused by a price spike; and

a. [Intentionally left blank]

b. [Intentionally left blank]

5.3.4.3 the *minimum trading limit* for a *market participant* that is not a *metered market participant* who has not transacted for at least 3 months in the *real-time market*, shall be equal to 25% of the *market participant's* estimate of its net *settlement amount* for the upcoming *energy market billing period*. Such a *market participant* shall provide to the *IESO*, an estimate of its net *settlement amount* for the upcoming *energy market billing period* at least 7 *business days* prior to the start of applicable *energy market billing period*. The *IESO* may adjust the *market participant's minimum trading limit* at any time if that *market participant's* actual net *settlement amounts* for the current *billing period* are projected to differ significantly from the estimate provided.

5.3.4A [Intentionally left blank]

5.3.4A.1 [Intentionally left blank]

a. [Intentionally left blank]

b. [Intentionally left blank]

5.3.4A.2 [Intentionally left blank]

5.3.4B [Intentionally left blank]

5.3.4B.1 [Intentionally left blank]

a. [Intentionally left blank]

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i. [Intentionally left blank]

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d. [Intentionally left blank]

e. [Intentionally left blank]

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ii. [Intentionally left blank]

5.3.4B.2 [Intentionally left blank]

a. [Intentionally left blank]

- b. [Intentionally left blank]
- c. [Intentionally left blank]
  - i. [Intentionally left blank]
  - ii. [Intentionally left blank]
- d. [Intentionally left blank]
- e. [Intentionally left blank]
  - i. [Intentionally left blank]
  - ii. [Intentionally left blank]

5.3.4C [Intentionally left blank]

**Establishing Market Participant Trading Limit**

5.3.5 Upon receipt of a *market participant's self-assessed trading limit* under section 5.3.2, the *IESO* shall use the greater of the following two amounts for that *market participant's trading limit* for the upcoming *energy market billing period*:

5.3.5.1 the *market participant's minimum trading limit* for that *energy market billing period* as determined pursuant to section 5.3.4; or

5.3.5.2 the *market participant's self-assessed trading limit* submitted under section 5.3.2.

5.3.6 If a *market participant* does not provide a *self-assessed trading limit* within the timelines specified in section 5.3.2, the *IESO* shall use the greater of the following two amounts for that *market participant's trading limit* for the upcoming *energy market billing period*:

5.3.6.1 the *market participant's minimum trading limit* for that *energy market billing period* as determined pursuant to section 5.3.4; or

5.3.6.2 the *market participant's trading limit* in effect for the current *energy market billing period*.

5.3.6.3 [Intentionally left blank]

5.3.6.4 [Intentionally left blank]

5.3.6.5 [Intentionally left blank]

5.3.6A [Intentionally left blank]



- 5.3.7 Once a *market participant's trading limit* has been established pursuant to section 5.3.5 or 5.3.6, that *market participant* is not permitted to change or request a change to that *trading limit* during the upcoming *energy market billing period*.

#### **Establishing Market Participant Default Protection Amount**

- 5.3.8 The *IESO* shall, for each *energy market billing period*, establish a *default protection amount* for each *market participant* as follows:
- 5.3.8.1 for a *metered market participant*, its *default protection amount* shall be equal to the *IESO's* estimate of the *metered market participant's* net *settlement amounts* for that *energy market billing period*, excluding estimated *settlement amounts* associated with the *energy forward market* and estimated *settlement amounts* associated with a *transmission right*, assuming 21 days of participation in the *real-time market* and assuming all *energy* injected or withdrawn is transacted through the *real-time market*; and
- 5.3.8.2 for a *market participant* that is not a *metered market participant*, the *default protection amount* shall be equal to the *minimum trading limit* for that *market participant* for that *energy market billing period* as determined by the *IESO* pursuant to section 5.3.4.2 or section 5.3.4.3, as applicable.

#### **Adjusting Trading Limit and Default Protection Amount for Physical Bilateral Contracts**

- 5.3.8A A *metered market participant* with a credit rating of BBB- or higher, subject to any adjustment under section 5.8.2, may request its *minimum trading limit* and *default protection amount* be calculated removing the *energy quantities* associated with the participant's *physical bilateral contracts* registered with the *IESO* provided it submits to the *IESO* the quantity and duration of the applicable *physical bilateral contracts* and it notifies the *IESO* immediately upon a change in the quantity or duration of the *physical bilateral contracts* including the termination of any of the contracts.
- 5.3.8B If the conditions of 5.3.8A are met the *IESO* shall determine the *metered market participant's* *minimum trading limit* and *default protection amount* assuming all *energy* injected or withdrawn is transacted through the *real-time market* net of *energy quantities* associated with those *physical bilateral contracts*.

#### **Requirement to Provide Prudential Support**

- 5.3.9 If a *market participant's* *maximum net exposure*, as calculated by the *IESO*, is zero or negative, the *market participant* is not required to provide any form of *prudential support* to the *IESO*. If a *market participant's* *maximum net exposure*, as calculated by the *IESO*, is positive, the *market participant* must provide an amount of *prudential support* to the *IESO* equal to its *prudential support obligation*.

### Price Bases Used for Determining Minimum Trading Limit and Default Protection Amount

5.3.10 The *IESO* shall estimate the net *settlement amounts* for a *market participant* referred to in sections 5.3.4 and 5.3.8 initially based on information provided to the *IESO* by the *market participant* in its *application for authorization to participate* and subsequently using such information as the *IESO* may reasonably require for that purpose and, in each case, on the price bases referred to in 5.3.10A, and the *IESO*'s estimated market prices for all other applicable charges for the relevant energy market billing period.

5.3.10A When calculating the *minimum trading limit* and the *default protection amount* for *metered market participants* in sections 5.3.4, 5.3.8 and 5.3.8B respectively, the *IESO* shall establish and use as its price basis the following:

5.3.10A.1 for a *metered market participant* other than a *distributor*, the applicable Regulated Price Plan supply cost or its equivalent published by the *OEB*; or

5.3.10A.2 for a *metered market participant* that is a *distributor*, the applicable Regulated Price Conventional Meter Tier 1 price or its equivalent published by the *OEB*.

5.3.10B The *IESO* shall annually review each price basis referred to in section 5.3.10A. The *IESO* shall modify the applicable price basis if it has increased or decreased by 15% or more from the price basis used by the *IESO*.

### Reviewing and Modifying Trading Limits, Default Protection Amount and Maximum Net Exposure

5.3.11 The *IESO* shall review the *minimum trading limit* where applicable, and the *trading limit, default protection amount* and *maximum net exposure* of each *market participant* as follows:

5.3.11.1 prior to the start of each *energy market billing period*;

5.3.11.2 within two *business days* after a *market participant's actual exposure* exceeds the *trading limit* for that *market participant*;

5.3.11.3 within two *business days* after it receives notice of any changes to the status of a *market participant* as compared to such status that was in effect when the *market participant's maximum net exposure* was last calculated if the *IESO* determines that the change in such status would have a material impact on the *market participant's maximum net exposure*; **and**

5.3.11.4 when the *IESO* has adjusted a *market participant's minimum trading limit* pursuant to section 5.3.4.3-; **and**

5.3.11.5 when the *IESO* has adjusted its price basis under section 5.3.10B.

- 5.3.12 The *IESO* may change the *minimum trading limit, trading limit, default protection amount, maximum net exposure* or the *prudential support obligation* for a *market participant* at any time as a result of a review conducted pursuant to section 5.3.11 and shall promptly notify the *market participant* of any such change. Any change to a *market participant's minimum trading limit, trading limit, default protection amount, maximum net exposure* or *prudential support obligation* shall apply with effect from such time, not being earlier than the time of notification of the changed *minimum trading limit, trading limit, default protection amount, maximum net exposure* or *prudential support obligation* to the *market participant*, as the *IESO* may specify in the notice. The *market participant* must supply the *IESO*, within five *business days* of the effective date of the change, any additional *prudential support* that may be required as a result of an increase in the *market participant's prudential support obligation* that results from such change.

#### **PART 5 – IESO BOARD DECISION RATIONALE**

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## Market Rule Amendment Proposal

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### PART 1 – MARKET RULE INFORMATION

Identification No.:	<b>MR-00212-R01</b>		
Subject:	<b>Prudential Support</b>		
Title:	<b>Revisions to Prudential Support Obligations</b>		
Nature of Proposal:	<input checked="" type="checkbox"/> Alteration	<input type="checkbox"/> Deletion	<input type="checkbox"/> Addition
Chapter:	2	Appendix:	
Sections:	5.7		
Sub-sections proposed for amending:	5.7.2.1, , 5.7.2.4, 5.7.3A, 5.7.4, 5.7.4A		

### PART 2 – PROPOSAL HISTORY – PLEASE REFER TO MR-00212-R00

Version	Reason for Issuing	Version Date
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**

This amendment proposes to modify the prudential support obligations for Market Participants in accordance with the recommendations contained within SE-23 Prudential Review Report.

The changes are to permit the IESO to have discretion over the terms of a bank guarantee, and define acceptable institutions as a bank named in a Schedule to the Bank Act, or a credit union licensed by the Financial Services Commission of Ontario (FSCO), in either case having a specified minimum long-term credit rating from an IESO approved credit rating agency.

In addition it is also proposed to cap the amount of a guarantee that can provided to a market participant, which is not a distributor, by an affiliate and to specify in a separate section the applicable affiliate guarantee caps for a market participant that is a distributor.

**Background**

For further information please refer to MR-00212-R00 and/or the SE-23 Prudential Review Report which can be found at the following link:

<http://www.ieso.ca/imoweb/pubs/consult/se23/se23-20070313-Prudential-Review-Report.pdf>

**Discussion**

It is proposed to amend section 5.7.2 in the following manner:

- Modify section 5.7.2.1 to obligate the market participant to provide a guarantee in a form which is acceptable to the IESO; market participants are currently obligated to provide a letter of credit in a form acceptable to the IESO. This follows recommendation 12.3 from the SE-23 report.
- Modify section 5.7.2.1 to specify that a bank with a long-term credit rating of A from a major bond rating agency is an acceptable provider of a market participant's prudential support. This was identified in recommendation 9.3 from the SE-23 Report.
- Modify section 5.7.2.1 to include credit unions that have a minimum long-term credit rating of "A" from a major bond rating agency as being eligible to provide a market participant's prudential support. This was identified in recommendation 9.3 from the SE-23 Report.

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The amount that a guarantor can guarantee is determined in exactly the same manner as a publicly rated market participant's reduction in prudential support is determined; by its credit rating and associated reductions under the market rules. Therefore, when the amount of an allowable reduction changes for any category of credit rating for market participants, so must a commensurate change occur for a guarantor. The SE-23 Report did not directly address the need to adjust the guarantor caps, however, these changes are a direct result of the SE-23 Report's recommendations on the need to modify the reductions in prudential support obligations permissible for credit ratings.

In accordance with the above it is also proposed to amend section 5.7.4 of the market rules in the following manner:

- Modify the table in section 5.7.4 for market participants who are not distributors to ensure that the amount that a guarantor can guarantee is no more or no less than a publicly rated market participant receives as a reduction. This section must be amended to reflect any changes made to Section 5.81. and 5.8.1A (please see MR-00212-R02).
- Insert a new section 5.7.4A to specify for market participants who are distributors that the amount that a guarantor can guarantee is no more or less than a publicly rated market participant receives as a reduction. This new section is consistent with the SE-23 Report in regard to the conclusion that local distribution companies should continue to be treated differently from other aspects of the prudential framework. For further information on the proposed changes to credit ratings please refer to MR-00212-R02.

### PART 4 – PROPOSED AMENDMENT

## 5.7 Obligation to Provide Prudential Support

5.7.1 Each *market participant* must meet its obligation under this section 5 to provide and maintain *prudential support* by providing to the *IESO* and maintaining *prudential support*, the value of which is equal to the *market participant's prudential support obligation*.

5.7.2 A *market participant's prudential support obligation* must be met through the provision to the *IESO* and the maintenance of *prudential support* in one or more of the following forms:

- 5.7.2.1 a guarantee or irrevocable commercial letter of credit, which in both cases must be -in a form acceptable to the IESO and -provided by:
- a. a bank named in a Schedule to the *Bank Act*, S.C. 1991, c.46 with a minimum long-term credit rating of "A" from a major bond rating agency as identified in the list referred to in section 5.8.7; or
  - b. a credit union licensed by the Financial Services Commission of Ontario with a minimum long-term credit rating of "A" from a

major bond rating agency as identified in the list referred to in section 5.8.7.

- 5.7.2.2 a guarantee in a form acceptable to the *IESO* provided by a person, other than an *affiliate* of the *market participant*, having a credit rating from a major bond rating agency identified on the list referred to in section 5.8.7;
- 5.7.2.3 marketable securities in the form of Canadian Government treasury bills. Such treasury bills shall be valued as cash at their current market value less 2 percent to take into account the potential eroding effects of interest rate increases;
- 5.7.2.4 subject to section 5.7.4 and 5.7.4A, a guarantee in a form acceptable to the *IESO* provided by a person that is an *affiliate* of the *market participant* and that has a credit rating from a major bond rating agency identified on the list referred to in section 5.8.7; and/or
- 5.7.2.5 cash deposits made with the *IESO* by or on behalf of the *market participant* provided that that *market participant* meets the following criteria:
- a. the *market participant* was already meeting its *prudential support obligation* in whole or in part through a cash deposit on November 4, 2004; and
  - b. the *market participant's prudential support obligation* was less than or equal to \$200,000 on November 4, 2004 and remains less than or equal to \$200,000 thereafter.
- 5.7.3 For the purposes of sections 5.7.2.1 and 5.7.2.2, the *IESO* shall establish, maintain, update as required and *publish* a list of organizations eligible to provide the *prudential support* referred to in sections 5.7.2.1 and 5.7.2.2 and shall establish, for each such eligible *prudential support* provider, an aggregate limit of the *prudential support* that may be provided by that *prudential support* provider to *market participants*. If aggregate limits are reached for any of these eligible organizations, *market participants* will be required to obtain *prudential support* from other eligible organizations that are still within their respective *prudential support* limits.
- 5.7.3A Where a *market participant's prudential support obligation* is reduced pursuant to section 5.8.1 or 5.8.1A, 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.

- 5.7.4 For market participants, other than a distributor, Subject subject to sections 5.7.3A and 5.7.3B the IESO shall not accept a guarantee from an rated affiliate of the *market participant* pursuant to section 5.7.2.4 where the value of the guarantee exceeds the following;

<b>Credit Rating Category of Affiliate using Standard and Poor's Rating Terminology</b>	<b>Maximum Amount which May be Guaranteed by Affiliate</b>
<del>AAA and above or equivalent</del>	<del>100% of maximum net exposure of all market participants guaranteed by affiliate</del>
<del>AA-, AA, AA+ or equivalent and above or equivalent</del>	<del>Greater of 85% 100% of maximum net exposure or \$25,000,000 of all market participants guaranteed by affiliate</del>
A-, A, A+ or equivalent	Greater of <del>75</del> 85% of maximum net exposure or <del>\$12,500,000</del> 25,000,000 of all market participants guaranteed by affiliate
BBB-, BBB, BBB+ or equivalent	Greater of <del>50</del> 60% of maximum net exposure or <del>\$5</del> 10,000,000 of all market participants guaranteed by affiliate
<del>Below BBB or equivalent</del> BB-, BB, BB+ or equivalent	<del>0</del> Greater of 25% of maximum net exposure or \$3,000,000 of all market participants guaranteed by affiliate
<del>Below BB- or equivalent</del>	<del>0</del>

- 5.7.4A For distributors, subject to sections 5.7.3A and 5.7.3B the IESO shall not accept a guarantee from a rated affiliate of the market participant pursuant to section 5.7.2.4 where the value of the guarantee exceeds the following:

<b><u>Credit Rating Category of Affiliate using Standard and Poor's Rating Terminology</u></b>	<b><u>Maximum Amount which May be Guaranteed by Affiliate</u></b>
<u>AA- and above or equivalent</u>	<u>100% of maximum net exposure of all market participants guaranteed by affiliate</u>
<u>A-, A, A+ or equivalent</u>	<u>Greater of 90% of maximum net exposure or \$30,000,000 of all market participants guaranteed by affiliate</u>
<u>BBB-, BBB, BBB+ or equivalent</u>	<u>Greater of 75% of maximum net exposure or \$15,000,000 of all market participants guaranteed by affiliate</u>
<u>BB-, BB, BB+ or equivalent</u>	<u>Greater of 50% of maximum net exposure or \$5,000,000 of all market participants guaranteed</u>

	<u>by affiliate</u>
<u>Below BB- or equivalent</u>	<u>0</u>

- 5.7.5 The minimum terms and conditions that shall be included in the *prudential support* shall be as follows:
- 5.7.5.1 *prudential support* provided in accordance with sections 5.7.2.1, 5.7.2.2 and 5.7.2.4 shall be obligations in writing;
  - 5.7.5.2 *prudential support* provided in accordance with sections 5.7.2.3 and 5.7.2.5 shall be obligations reflected in a written instrument in a form acceptable to the *IESO*;
  - 5.7.5.3 *prudential support* provided in accordance with sections 5.7.2.1, 5.7.2.3 and 5.7.2.5 shall constitute valid and binding unsubordinated obligations to pay to the *IESO* amounts in accordance with its terms which relate to the obligations of the relevant *market participant* under the *market rules*; and
  - 5.7.5.4 *prudential support* provided in accordance with sections 5.7.2.1 to 5.7.2.5 shall permit drawings or claims by the *IESO* on demand to a stated certain amount.

**PART 5 – IESO BOARD DECISION RATIONALE**




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## Market Rule Amendment Proposal

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### PART 1 – MARKET RULE INFORMATION

Identification No.:	<b>MR-00212-R02</b>		
Subject:	<b>Prudential Support</b>		
Title:	<b>Revisions to Prudential Support Obligations</b>		
Nature of Proposal:	<input checked="" type="checkbox"/> Alteration	<input type="checkbox"/> Deletion	<input type="checkbox"/> Addition
Chapter:	2	Appendix:	
Sections:	5.8		
Sub-sections proposed for amending:	5.8.1, 5.8.1A, 5.8.2, 5.8.4, 5.8.5, 5.8.6, 5.8.7		

### PART 2 – PROPOSAL HISTORY – PLEASE REFER TO MR-00212-R00

Version	Reason for Issuing	Version Date
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

This amendment proposes to modify the prudential support obligations for Market Participants in accordance with the recommendations contained within SE-23 Prudential Review Report.

Specifically it is proposed to modify the credit rating reductions permissible for market participants who are not distributors and modify the credit rating reductions permissible for market participants who are distributors.

Also, it is proposed to modify the IESO's obligation to deem automatically the reduction of a market participant's credit rating upon the recommendation to move a market participant to credit watch status by any of the major bond rating agencies recognized. This was not referenced in the SE-23 Prudential Review Report therefore a discussion on this issue is provided below.

For further information please refer to MR-00212-R00.

#### Background

For further information please refer to MR-00212-R00 and/or the SE-23 Prudential Review Report which can be found at the following link:

<http://www.ieso.ca/imoweb/pubs/consult/se23/se23-20070313-Prudential-Review-Report.pdf>

#### Discussion

It is proposed to amend section 5.8.1 by specifying that the table for reductions in prudential support obligations for credit ratings is applicable to market participants who are not distributors in accordance with SE-23 Report Recommendation 6.3. It is proposed within the body of the table to:

- Specify that credit ratings AA- and above all receive the same reduction which is 100% of maximum net exposure.
- Specify that credit ratings A-, A, A+ or equivalent will be eligible for a reduction which is the greater of 85% of maximum of net exposure or \$25,000,000
- Specify that credit ratings BBB-, BBB, BBB+ or equivalent will be eligible for a reduction which is the greater of 60% of maximum of net exposure or \$10,000,000.
- Specify that credit ratings BB-, BB, BB+ or equivalent will be eligible for a reduction which is the greater of 25% of maximum net exposure or \$3,000,000.
- Specify that credit ratings BB- or equivalent will not be eligible for any reduction in prudential support.

### PART 3 – EXPLANATION FOR PROPOSED AMENDMENT

It is proposed to insert a new section 5.8.1A including a table which will specify the permissible reductions in prudential support obligations for credit ratings for market participants who are distributors in accordance with SE-23 Report Recommendation 6.3. It is proposed within the body of the table to:

- Specify that credit ratings AA- and above all receive the same reduction which is 100% of maximum net exposure.
- Specify that credit ratings A-, A, A+ or equivalent will be eligible for a reduction which is the greater of 90% of maximum of net exposure or \$30,000,000
- Specify that credit ratings BBB-, BBB, BBB+ or equivalent will be eligible for a reduction which is the greater of 75% of maximum of net exposure or \$15,000,000.
- Specify that credit ratings BB-, BB, BB+ or equivalent will be eligible for a reduction which is the greater of 50% of maximum net exposure or \$5,000,000.
- Specify that credit ratings BB- or equivalent will not be eligible for any reduction in prudential support.

It is also proposed to amend section 5.8.2 to specify the conditions under which the IESO shall be obligated to automatically reduce a market participant's credit rating by "one-notch" rather than by "one category". This amendment is not a recommendation included in the Report. The term "one category" is not the correct term to use in this case and has resulted in the IESO having to apply far stricter sanctions than was originally intended. A one category reduction due to being placed on credit watch negative can result in a participant having to post up to 50% more prudential support until the credit rating agency makes its final determination. In most cases, a credit rating agency moves credit ratings by notches (i.e. from BBB to BBB-) not by whole categories. The IESO believes the existing rule is not appropriate and it could create material negative implications for market participants.

It is also proposed to modify sections 5.8.4 and 5.8.5 by converting the existing obligations, permissions, and authorities into an easy-to-read table which is comparable to the tables found in sections 5.8.1 and 5.8.1A. During the stakeholder review process it was suggested to the IESO that these sections could be easily converted into tables to make it easier for the reader to understand what the rules actually say. The IESO strongly agrees with our stakeholders and thus has modified this section to also include format changes as well.

It is proposed to amend section 5.8.6 to reference the new proposed table in section 5.8.1A. The restrictions stated in section 5.8.6 should also apply to the new table in section 5.8.1A.

It is also proposed to amend section 5.8.7 to specify that for all purposes set out in this chapter of the market rules the IESO shall establish, maintain, update as required and publish a list of major bond rating agencies eligible to provide the credit ratings.

### PART 4 – PROPOSED AMENDMENT

## 5.8 Reductions in Prudential Support Obligations

5.8.1 Subject to section 5.8.2, the *prudential support obligation* of a rated market participant, other than a distributor, may be reduced relative to the *market participant's maximum net exposure* by an amount equal to the monetary value aprescribed, by the table set forth below, to a credit rating from a major bond rating agency identified in the list referred to in section 5.8.7 issued and in effect in respect of the *market participant*.

Credit Rating Category using Standard and Poor's Rating Terminology	Allowable Reduction in Prudential Support
<u>AAA- and above or equivalent</u>	<u>100% of maximum net exposure</u>
<u>AA-, AA, AA+ or and above or equivalent</u>	<u>100% of maximum net exposure Greater of 85% of maximum net exposure or \$25,000,000</u>
<u>A-, A, A+ or equivalent</u>	<u>Greater of 75%85% of maximum net exposure or \$12,500,00025,000,000</u>
<u>BBB-, BBB, BBB+ or equivalent</u>	<u>Greater of 50%60% of maximum net exposure or \$5,000,00010,000,000</u>
<u>BB-, BB, BB+ or equivalent</u>	<u>Greater of 25% of maximum net exposure or \$3,000,000</u>
<u>Below BBB- or equivalent</u>	<u>0</u>

5.8.1A Subject to section 5.8.2, the prudential support obligation of a rated distributor may be reduced relative to the market participant's maximum net exposure by an amount equal to the monetary value prescribed, by the table below, to a credit rating from a major bond rating agency identified in the list referred to in section 5.8.7 issued and in effect in respect of the market participant.

<u>Credit Rating Category using Standard and Poor's Rating Terminology</u>	<u>Allowable Reduction in Prudential Support</u>
<u>AA- and above or equivalent</u>	<u>100% of maximum net exposure</u>
<u>A-, A, A+ or equivalent</u>	<u>Greater of 90% of maximum net exposure or \$30,000,000</u>
<u>BBB-, BBB, BBB+ or equivalent</u>	<u>Greater of 75% of maximum net exposure or \$15,000,000</u>
<u>BB-, BB, BB+ or equivalent</u>	<u>Greater of 50% of maximum net exposure or \$5,000,000</u>
<u>Below BB- or equivalent</u>	<u>0</u>

- 5.8.2 Any recommendation to move a *market participant* to “credit watch statusnegative” by any of the major bond rating agencies identified in the list referred to in section 5.8.7 shall be deemed to automatically result in a one-notchrating-category 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 prudential support obligation*.
- 5.8.2A The operation of section 5.8.2 shall be suspended for *distributors* as of November 19, 2002, until February 14, 2003 or until such other date as may be determined by a resolution of the *IESO Board*. The management of the *IESO* shall monitor and report to the *IESO Board* on the credit situation of *distributors* and other *market participants* and the *IESO Board* shall modify the suspension of section 5.8.2 (or, if appropriate, shall expand the scope of the suspension) if the credit situation changes in a way that makes such modification desirable.
- 5.8.3 Subject to section 5.8.6, the *prudential support obligation* of a *market participant* may be reduced relative to the *market participant’s maximum net exposure* or, where applicable, relative to the otherwise applicable *prudential support obligation* calculated in accordance with section 5.3.4B, by an amount equal to the monetary value ascribed, in accordance with section 5.8.4 or 5.8.5, to the *market participant’s* historical good payment history in Ontario, which shall be assessed by the *IESO* on the basis of:
- 5.8.3.1 evidence provided by the *market participant* as to the continuous purchase of electricity by the *market participant* prior to the effective date of the *IESO-administered markets* during which time no call for collateral was issued to that *market participant* to protect the supplier from the risk of a payment default by that *market participant*;
- 5.8.3.2 verification of the evidence referred to in section 5.8.3.1 by the *IESO*; and
- 5.8.3.3 the *market participant’s* payment history in the *IESO-administered markets* provided that the *market participant’s* payment history includes no *event of default*.
- 5.8.4 The *IESO* shall determine the dollar amount of any allowable reduction in the *prudential support obligation* of an unrated *market participant*, other than a *distributor*, in accordance with the following: by an amount equal to the monetary value prescribed, by the table below:

<u>Good Payment History Categories for Non-Distributors</u>	<u>Allowable Reduction in Prudential Support</u>
<u>&gt;6 years</u>	<u>Lesser of 40% of maximum net exposure or \$6,000,000</u>
<u>&gt;5 years, &lt;6 years</u>	<u>Lesser of 25% of maximum net exposure or \$5,000,000</u>

<u>≥4, &lt;5 years</u>	<u>Lesser of 20% of maximum net exposure or \$4,000,000</u>
<u>≥3, &lt;4 years</u>	<u>Lesser of 15% of maximum net exposure or \$3,000,000</u>
<u>≥2, &lt;3 years</u>	<u>Lesser of 10% of maximum net exposure or \$2,000,000</u>
<u>&lt;2 years</u>	<u>0</u>

~~5.8.4.1 — a market participant with less than two years of historical good payment history shall not be entitled to any reduction in its prudential support obligation;~~

~~5.8.4.2 — a market participant with two or more but less than three years of historical good payment history shall be entitled to a reduction in its prudential support obligation equal to two million dollars or ten percent of its maximum net exposure, whichever is less;~~

~~5.8.4.3 — a market participant with three or more but less than four years of historical good payment history shall be entitled to a reduction in its prudential support obligation equal to three million dollars or fifteen percent of its maximum net exposure, whichever is less;~~

~~5.8.4.4 — a market participant with four or more but less than five years of historical good payment history shall be entitled to a reduction in its prudential support obligation equal to four million dollars or twenty percent of its maximum net exposure, whichever is less; and~~

~~5.8.4.5 — a market participant with five years or more of historical good payment history shall be entitled to a reduction in its prudential support obligation equal to five million dollars or twenty five percent of its maximum net exposure, whichever is less.~~

5.8.5 If the market participant is an unrated distributor, the IESO shall determine the dollar amount of any allowable reduction in the market participant’s prudential support obligation by an amount equal to the monetary value prescribed, by the table below; ~~in accordance with the following:~~

<u>Good Payment History Categories for Distributors</u>	<u>Allowable Reduction in Prudential Support</u>
<u>≥6 years</u>	<u>Lesser of 70% of maximum net exposure or \$7,000,000</u>
<u>≥5 years, &lt;6 years</u>	<u>Lesser of 60% of maximum net exposure or \$6,000,000</u>



<u>&gt;4, &lt;5 years</u>	<u>Lesser of 40% of maximum net exposure or \$5,000,000</u>
<u>&gt;=3, &lt;4 years</u>	<u>Lesser of 30% of maximum net exposure or \$4,000,000</u>
<u>&gt;=2, &lt;3 years</u>	<u>Lesser of 20% of maximum net exposure or \$3,000,000</u>
<u>&lt;2 years</u>	<u>0</u>

~~5.8.5.1 — a market participant with less than two years of historical good payment history shall not be entitled to any reduction in its prudential support obligation;~~

~~5.8.5.2 — a market participant with two or more but less than three years of historical good payment history shall be entitled to a reduction in its prudential support obligation equal to two million dollars or twenty percent of its maximum net exposure, whichever is less;~~

~~5.8.5.3 — a market participant with three or more but less than four years of historical good payment history shall be entitled to a reduction in its prudential support obligation equal to three million dollars or thirty percent of its maximum net exposure, whichever is less;~~

~~5.8.5.4 — a market participant with four or more but less than five years of historical good payment history shall be entitled to a reduction in its prudential support obligation equal to four million dollars or forty percent of its maximum net exposure, whichever is less; and~~

~~5.8.5.5 — a market participant with five years or more of historical good payment history shall be entitled to a reduction in its prudential support obligation equal to five million dollars or fifty percent of its maximum net exposure, whichever is less.~~

For purposes of this section 5.8.5, the historical payment history of a *distributor* that is the transferee under a transfer by-law made pursuant to subsection 145(1) of the *Electricity Act, 1998* shall be deemed to include the historical payment history of the *distributor* whose license has been transferred to the transferee under such by-law. For purposes of this section 5.8.5, the historical payment history of a *distributor* that is the successor at law to two or more *distributors*, shall be deemed to include the historical payment history of the predecessor *distributors*.

- 5.8.6 The following restrictions shall apply to the provision of reductions in a *market participant's prudential support obligation* as provided for under sections 5.8.1, [5.8.1A](#), and 5.8.3:
- 5.8.6.1 subject to the last paragraph of section 5.8.5, a *market participant* shall not be entitled to a reduction in its *prudential support obligation* pursuant to section 5.8.3 using the payment history of an *affiliate*; and
- 5.8.6.2 a *market participant* that has a credit rating from a major bond rating agency identified in the list referred to in section 5.8.7 shall not be entitled to a reduction in its *prudential support obligation* under section 5.8.3.
- 5.8.7 For the purposes of ~~section 5.7.2.2, 5.7.2.4, 5.8.1 and 5.8.2~~[this chapter](#), the *IESO* shall establish, maintain, update as required and *publish* a list of major bond rating agencies eligible to provide the credit ratings [mentioned throughout](#).
- 5.8.8 The *IESO* shall reduce the *prudential support obligation* of a *distributor* by an amount equal to 60% of the *distributor's* collection of *prudential support*, in the forms specified in section 5.7.2.1, 5.7.2.2, 5.7.2.3, or 5.7.2.4, from the *distributor's* customers. In order to qualify for this reduction in *prudential support obligation* the *distributor* shall provide the *IESO* with an affidavit attesting to the amount of *prudential support* of the types specified in this section which the *distributor* has collected from its customers attached to which by way of exhibits shall be copies of bank statements showing any cash deposits and any applicable letters of credit, guarantees, or Government of Canada T-bills held as *prudential support*. The *IESO* shall first deduct the *distributor's* collection of *prudential support* from the *distributor's* customers before applying any other *prudential support obligation* deductions.

## PART 5 – IESO BOARD DECISION RATIONALE

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## Market Rule Amendment Proposal

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### PART 1 – MARKET RULE INFORMATION

Identification No.:	MR-00212-R03		
Subject:	Prudential Support		
Title:	Revisions to Prudential Support Obligations		
Nature of Proposal:	<input checked="" type="checkbox"/> Alteration	<input type="checkbox"/> Deletion	<input type="checkbox"/> Addition
Chapter:	2	Appendix:	
Sections:	5.1		
Sub-sections proposed for amending:	5.1.2 (new)		

### PART 2 – PROPOSAL HISTORY – PLEASE REFER TO MR-00212-R00

Version	Reason for Issuing	Version Date
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**

This amendment proposes to create an obligation for the IESO to review the prudential support requirements at least once every three years.

At its meeting on April 26, 2007 the IESO Board directed IESO Management to conduct a review of the Real-time Market prudential framework at least once every three years. This recommendation is not contained directly in the SE-23 Prudential Review Report. The Stakeholder Advisory Committee (SAC) at its April 4, 2007 meeting reviewed the SE-23 Report and recommended to the IESO Board that a review of the prudential requirements should be conducted by the IESO every two to three years.

**Background**

For further information please refer to MR-00212-R00 and/or the SE-23 Prudential Review Report which can be found at the following link:

<http://www.ieso.ca/imoweb/pubs/consult/se23/se23-20070313-Prudential-Review-Report.pdf>

**Discussion**

In order to implement the IESO Board's direction it is proposed to insert a new subsection 5.1.2 to specify that the IESO shall review the prudential support requirements at least once every three years and that the first review shall be completed no later than September 1, 2010.

**PART 4 – PROPOSED AMENDMENT**

## **5. Prudential Requirements**

### **5.1 Purpose**

5.1.1 This section 5 sets forth the nature and amount of *prudential support* that must be provided by *market participants* as a condition of participation in the *real-time markets* or of causing or permitting electricity to be conveyed into, through or out of the *IESO-controlled grid*, and the manner in which *market participants* must provide and maintain such *prudential support* on an on-going basis in order to protect the *IESO* and *market participants* from payment defaults.

5.1.2 The IESO shall review the prudential support requirements set out in this chapter at least once every three years. The first review shall be completed no later than September 30, 2010.

**PART 5 – IESO BOARD DECISION RATIONALE**

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