UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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Credit Reforms in Organized	)	
Wholesale Electric Markets	)	**Docket No. RM20-**
	)	

ENERGY TRADING INSTITUTE REQUEST FOR TECHNICAL CONFERENCE AND PETITION FOR RULEMAKING TO UPDATE CREDIT AND RISK MANAGEMENT RULES AND PROCEDURES IN THE ORGANIZED MARKETS

Pursuant to Rule 207 of the Commission's Rules of Practice and Procedure, the Energy Trading Institute ("ETI") respectfully requests that the Federal Energy Regulatory Commission ("Commission") hold a technical conference and conduct a rulemaking to update the requirements adopted in Order No. 741 and Section 35.47 of the Commission's regulations addressing credit and risk management in the markets operated by Independent System Operators ("ISOs") and Regional Transmission Operators ("RTOs").[1] Good credit policy is the cornerstone of any market and the Commission's guidelines in Section 35.47 were appropriate at the time. However, given the recent GreenHat default and the evolution of these markets over the last decade since the issuance of Order No. 741, ETI strongly believes that the Commission and industry should engage in a dialogue to ensure that credit and risk management practices and procedures in the ISOs and RTOs are robust, do not create unnecessary barriers to entry or compliance burdens, and ensure that organized markets are secure in order to meet the Commission's goals of open access, competition and transparency.

[1] *Credit Reforms in Org Wholesale Elec. Mkts.*, 75 Fed. Reg. 65942 (2010), FERC Stats. & Regs. ¶ 31,317 (2010) (*Order No. 741*); *order on reh'g*, 76 Fed. Reg. 10492 (2011), FERC Stats. & Regs. ¶ 31,320 (2011) (*Order No. 741-A*); *order on reh'g*, 135 FERC ¶ 61,242 (2011) (*Order No. 741-B*); 18 C.F.R. § 35.47.

ETI is aware of several expedited initiatives underway at the ISOs and RTOs related to their credit policies.[2] It would be helpful for the Commission to consolidate any such filings with this proceeding and hold the technical conference ETI is requesting by March 30, 2020 so the ISOs, RTOs and their stakeholders consider those discussions in any initiatives they have underway. To be clear, ETI does not wish to delay any of these initiatives. Rather, it wants to ensure that these initiatives are as robust as possible and that the steps taken as a result provide the necessary protections for market participants to transact securely. In that vein, a notice of proposed rulemaking following the feedback received at the technical conference would help guide the discussion and expedite stakeholder efforts.

I. BACKGROUND ON ORDER NO. 741

In January 2010, the Commission initiated a rulemaking to address reforms to the credit practices in organized wholesale electric markets in light of the then ongoing financial crisis.[3] Prior to issuing the Credit NOPR, the Commission held a technical conference with speakers representing a wide array of experience and perspectives on credit risk management.[4] This helped lead to proposed rules that addressed certain key areas for improvement in how the ISOs and RTOs manage credit and market risk. The improvements the Commission adopted include: (i) shortened settlement cycles; (ii) limits on the use of unsecured credit in some markets and a complete prohibition on the use of

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[2] *See*, *e.g.*, *New York Indep. Sys. Operator, Inc.*, Proposed Tariff Amendments to Enhance Credit Reporting Requirements and Remedies, Docket No. ER20-483 (filed Nov. 26, 2019).

[3] *Credit Reforms in Org. Wholesale Elec. Mkts.*, 130 FERC ¶ 61,055 (2009) (*Credit NOPR*).

[4] *Technical Conference on Credit and Capital Issues*, Docket No. AD09-2 (Jan. 13, 2009). Speakers included representatives from Morgan Stanley, Southern Company, the New York Public Service Commission, the Chicago Mercantile Exchange, the Intercontinental Exchange, Calpine, ISO New England and the California Independent System Operator.

unsecured credit for all financial transmission rights-type markets; (iii) guidance on the rights of ISOs and RTOs to use netting and set-off; (iv) minimum criteria for market participation; and (v) clarification on when ISOs and RTOs could demand additional collateral from market participants.[5]

The ISOs and RTOs subject to the Commission's jurisdiction then filed tariff revisions to implement the Commission's guidance in Order Nos. 741 *et al*.[6] ETI believes that Order No. 741 has helped to protect markets and their participants over the last several years. For example, the shorter settlement periods in the energy and ancillary services markets have reduced the exposure that market participants could face in the event of a default. However, the passage of time has also allowed market participants, including ETI and its members, to see opportunities for additional improvements in the credit and risk management practices in the ISOs and RTOs. ETI's petition focuses on three areas for improvement: (1) credit risk management; (2) counterparty risk management; and (3) ISO/RTO internal risk management infrastructure and expertise.[7]

ETI also urges the Commission to explore through the technical conference and rulemaking whether Section 35.47 should be better enforced or further amended to promote just and reasonable credit and risk practices in the ISOs and RTOs. For example,

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[5] *Order No. 741* at PP 5-10; *see also* P 170 (adopting the credit rules "to ensure that credit practices currently in place in organized wholesale electric markets reasonably protect consumers against the adverse effects of default. To promote confidence in the markets, the Commission believes it is appropriate to adopt specific requirements regarding credit practices for organized wholesale electric markets. …The Commission believes these actions will enhance certainty and stability in the markets, and in turn, ensure that costs associated with market participant defaults do not result in unjust or unreasonable rates.").

[6] *See, e.g.*, *Cal. Indep. Sys. Operator Corp.*, Docket No. ER11-3973; *Midwest Indep. Transmission Sys. Operator, Inc.*, Docket No. ER11-3970; *PJM Interconnection, L.L.C.*, Docket No. ER11-3972.

[7] ETI expects that the technical conference it requests will identify additional areas for improvement.

Section 35.47(c) eliminated unsecured credit for financial transmission rights and equivalent products, yet several ISOs and RTOs currently allow market participants to hold positions without posting any collateral for those positions. This practice conflicts with Section 35.47(c) and should be stopped.

Similar to the process the Commission followed leading up to Order No. 741, ETI respectfully requests that the Commission hold a technical conference to begin to consider improvements to ISO/RTO credit and counterparty risk management practices. The technical conference should include key representatives from exchanges, futures commission merchants ("FCMs") and commercial entities that have been managing risk across multiple commodities successfully for several decades. ETI would greatly appreciate a forum in which industry experts can share information with the ISOs, RTOs and Commission staff and explore a fruitful path forward to enhanced credit policies and procedures that better fulfill the objectives the Commission set out in Order No. 741 and Section 35.47. ETI has provided a list of potential topics for discussion at the technical conference in Appendix A.

II. IMPROVEMENTS TO ISO/RTO CREDIT AND COUNTERPARTY PRACTICES AND PROCEDURES

A. Credit Support Requirements Should be Standardized Across ISOs and RTOs

There are industry best practices for setting up credit support requirements, such as using mark-to-auction tools to measure changes in exposure associated with an open position or requiring variation margin as the value of a position changes. These best practices are intended to ensure that a market participant posts the correct amount of credit support for the exposure they want to take on and that such credit support remains in place for the life of the exposure. To achieve this, every entity responsible for implementing a credit policy must adhere to the following credit principles:

- Determine the size of each market participant's anticipated exposure, typically based on the market participant's desired level of participation in the market;

- Determine whether the market participant should be allowed to trade at the desired level or some lesser level, based on a review of their financial and other relevant information;

- Determine the current market prices for the instrument to be traded (*e.g.*, FTRs) so a price can be applied to the exposure level (*i.e.*, volume) to determine the anticipated credit exposure;

- Calculate the amount of credit support needed to manage the default risk associated with the size and then-current market value of exposure the market participant will be allowed to take, whether it be the exposure level requested by the market participant or as adjusted to reflect the ISO's/RTO's determination of that participant's creditworthiness;

- Secure credit support in a form that can be easily accessed in the event of a payment default (*e.g.*, cash or letter of credit);

- Review daily the level of exposure the market participant has open and the credit support in place to secure the position, understanding that the risk will change as position volumes, position tenors, and market prices change;

- Demand credit support when exposure increases and return credit support when the exposure decreases for so long as the market participant has open positions; and

- Hold credit support until all open positions are closed.

ETI believes there should be uniformity in certain minimum credit requirements adopted across the organized markets, including requiring the ISOs and RTOs to demonstrate that their credit practices are consistent with the above principles.[8] Some foundational rules spanning all ISOs and RTOs are inherently necessary for credit models to function well.

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[8] ETI's proposal is similar to the reliability standards – there are national standards that set the minimum requirements that each regional entity must implement.

1. Current Credit Support Requirements Are Inconsistent and Ineffective

Each ISO/RTO has adopted different credit support requirements and such requirements are not effective in reducing exposure and detecting default risk.

a. Submission Credit and Hold Credit

Currently, each ISO/RTO is deploying a different risk model to determine submission credit[9] and hold credit,[10] often thought of as initial margin. Further, most ISOs/RTOs do not collect or refund what industry commonly refers to as variation margin.[11] The current ISO/RTO practices lead to arbitrary credit support requirements and credit support postings that do not adequately protect the markets or their participants, or practices that unnecessarily hold too much credit support relative to the position, thereby creating market inefficiencies and barriers to entry.

More specifically, certain organized markets (*e.g.*, Midcontinent ISO, SPP and ISO-NE) have inapposite submission credit requirements, on the one hand requiring submission credit as much as 10 times the anticipated exposure and, on the other, far lower hold credit requirements for cleared positions that under-collateralize the actual exposure of the position. The ISOs and RTOs should strike the right balance between the amount of submission and hold credit they require based on the protections they are seeking to achieve for each requirement. When striking this balance, the ISOs/RTOs should build credit models that ensure that submission credit is not a barrier to entry and that hold credit

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[9] ETI uses the term "submission credit" to mean the amount of credit support a market participant must post to submit bids in an FTR auction.

[10] ETI uses the term "hold credit" to mean the amount of credit a market participant must post to hold FTRs awarded after an auction.

[11] Variation margin is the amount collected or the amount refunded depending on the variation of the value of the portfolio resulting from a change in price for the positions held.

and variation margin is sufficient to cover a market participant's exposure. ETI recognizes that there is no perfect model. However, the current models substantially over- or under-collateralize in a manner not seen in other commodity markets. And only PJM has implemented mark-to-auction valuation, which relies on the current value of the position to assess credit requirements. Mark-to-auction (a.k.a. mark-to-market) is standard practice in other commodity markets, including in the Commission-jurisdictional bilateral markets.

The ISOs and RTOs should base their collateral models on the same principles outlined above. While different margin models can be utilized to assess initial and variation margin, basic principles such as mark-to-auction, variation margin and the other principles outlined above should be utilized as minimum benchmarks for developing and evaluating the sufficiency of each ISO/RTO credit model.

Finally, the ISOs and RTOs are not all using hold credit in a manner that protects the market. When used correctly, hold credit ensures that the ISO or RTO retains credit support for so long as the relevant position is open. This allows the ISO or RTO to have access to funds to draw upon if a market participant defaults. For example, MISO returns hold credit to counterflow FTR holders at the beginning of every month even though the market participant holds the counterflow position open for the entire month. MISO's assumption is that the counterflow FTR's value will remain in-the-money, however, this is not always the case. Put simply, the market participant then gets to hold those positions for free, thus enjoying unsecured credit notwithstanding Section 35.47. It would be more prudent and consistent with the law to return the credit support as the position is closed (*e.g.*, at the end of every week for that portion of a market participant's portfolio that ran off during the week). In another example, SPP provides transmission congestion rights

(“TCR”) holders a credit for historically strong performing paths. By not establishing a basic credit requirement for any position, SPP allows for large portfolios (*i.e.*, exposure) that require no collateral.

While ETI cites examples in the FTR markets, this is not solely an FTR market problem. Day-ahead market transactions and capacity market transactions are inadequately capitalized across several ISO/RTO markets. The ISOs/RTOs should conduct a comprehensive review of credit risk in every market in the organization and adapt their credit practices as appropriate.

b. Creditworthiness Limits on Holdings

The ISOs and RTOs should adopt limits that would ensure that each market participant is only allowed to put on positions they can actually afford (*i.e.*, pay for if the market turns against them, and the positions lose money). When ISOs and RTOs conduct credit reviews prior to permitting a market participant to enter into the ISO/RTO markets, the ISO/RTO should be looking at a market participant’s financial statements, capitalization, indicia of payment default history and other information to understand the creditworthiness of the market participant. An entity’s creditworthiness should also be reviewed periodically. ISOs/RTOs also should ensure that each market participant has adequate submission and hold credit support for positions to be acquired or positions to be held. The third piece of information the ISO/RTO must consider is what positions the market participant already has and how well those positions are collateralized. From there, the ISO/RTO should be able to determine how much more exposure the market participant should be allowed to take on, both in terms of size and tenor.

For example, if a market participant’s credit assessment indicates it can have $50 million in activity and the market participant has positions with current market-to-auction values totaling $40 million, the ISO or RTO would need to ensure that the market participant is only allowed to take on additional exposure consistent with the remaining $10 million available to that participant. The ISO or RTO credit policy would forbid the market participant from taking on additional exposure that would cause the market participant to exceed its $50 million threshold.

c. Consistent Capital Requirements

The ISOs and RTOs should have the same capitalization requirements and those requirements should be set at levels that are not arbitrary barriers to entry. ETI believes the minimum net worth requirement should be $1 million; it is high enough to signal the risk of participating in the markets but not so high as to unnecessarily discourage entry or negatively impact liquidity.

SPP is currently proposing to require a market participant to have $20 million in capitalization, meaning the funds cannot be utilized in another ISO/RTO market or utilized for bidding collateral, regardless of a market participant's activity in the market. This is an example of creating an unnecessary barrier to entry. The $20 million is an arbitrary number that may not protect the market. This type of requirement is likely to limit liquidity and actually result in additional volatility in the market. Further, it is unclear when or how SPP would measure available capital. Would the availability of funds be assessed during auction weeks, after auction weeks or would every company simply have to carry an additional, unutilized $20 million? Further, the $20 million requirement is not at all tied to exposure. Having appropriate initial and variation margin and position limits in place, however, would be tied to participation and serve as a protection mechanism for the market.

Moreover, having a high capitalization level does not mean a market participant cannot default or leave the ISO or RTO without recourse in the face of the default. Over the past several decades we have seen several large, well-capitalized entities in several industries default and cause consumers significant harm.[12] The capital solutions here should be right-sized at $1 million minimum and complemented by appropriate margin and position limit rules.

d. Reasonable Compliance Burdens

Allowing each ISO or RTO to create its own minimum participation requirements, including minimum net worth, officer certification and risk policy requirements has created a significant compliance burden for market participants. There are a separate set of similar, but different requirements for all six FERC-jurisdictional markets. This imposes an unnecessary burden on market participants because the differences do not result in reduced market exposure.

For example, a market participant might develop a risk policy to satisfy the requirements for entry into one ISO or RTO market. Five ISOs or RTOs may say the risk policy is satisfactory while another could require the market participant to make certain edits to the policy. All ISOs and RTOs are implementing the same guidance from the Commission and yet one out of six ISOs/RTOs can determine that the policy is inadequate while the other five ISOs/RTOs can determine that it is adequate. It would be preferable if the Commission provided guidance on how much detail a risk policy must have to be deemed to meet the minimum criteria. Market participants could still adopt policies that

[12] Many large market participants have filed for bankruptcy, including Pacific Gas and Electric (twice); FirstEnergy Solutions, Enron and Lehman Brothers. It can also happen to market operators, such as the California Power Exchange.

exceed the minimum standard the Commission adopts but the ISOs and RTOs should not have the ability to arbitrarily require a market participant to make revisions if their policy satisfies the minimum requirements.

Consistency across all ISOs/RTOs is just as important for minimum participation requirements. Market participants are currently left juggling six different sets of standards and attempting to develop policies and procedures around all six. Market participants should have the ability to know the minimum participation requirements for participation in all Commission-jurisdictional markets. There should be one set of standards, one set of disclosures and one set of certificates for entities to comply with the Commission's rules. The Commission also should consider having one entity that assesses these documents for all of the ISOs and RTOs to encourage consistency and reduce the overall compliance cost to the ISOs, RTOs, market participants and, in turn, ratepayers.

B. The ISOs and RTOs Need to Evaluate Counterparty Risk

As is evident from the recommendations related to the need for standardized credit practices, a holistic risk assessment entails looking at a wide variety of information about a market participant, not just determining if they meet the credit requirements for a particular market. ETI asks that the technical conference and rulemaking explore various ways to identify and mitigate counterparty risk.

1. Best Practices

Know-your-customer ("KYC") protocols and internal credit rating processes are widely used by other entities concerned about managing counterparty risk, including futures exchanges, FCMs, financial institutions and market participants themselves. ISOs and RTOs should implement counterparty risk assessment practices that would require them to look beyond whether a market participant has sufficient capital in order to participate in the market.

KYC protocols are generally ongoing procedures that involve annually requesting updated ownership structure information and searching for information on lawsuits, media coverage of adverse developments relating to the entity or other similar information.[13] KYC protocols are critical as they can alert the ISO or RTO to a significant issue with a market participant before that issue becomes material to the market participant's creditworthiness or overall business operations and can allow the ISO or RTO to take steps to mitigate its exposure to the risk the market participant may present. Thus, ETI believes each ISO/RTO should implement standardized, ongoing KYC practices consisting of the following features:

- Use KYC software to search each market participant.[14] These reviews help market operators identify changed circumstances that could diminish or enhance the creditworthiness of a market participant such as litigation, activist investors, mergers, and capital infusions.

- The KYC reviews should be run and re-run on a regular schedule so that an ISO or RTO has the ability to adapt to changed circumstances. For example, it is common for KYC reviews to identify reasons why a market may want to seek adequate assurance from a market participant regarding its ability to perform.

- KYC reviews also need to be run as part of every pre-auction credit check for any market participant that wants to participate in the auction. The information obtained in these pre-auction reviews could provide relevant information on whether a market participant is well-capitalized, litigation or regulatory/court settlements that require material payouts, future affiliations, and payment defaults.

- KYC reviews should be run if the ISO or RTO learns of a development that could put a market participant in jeopardy of default. For example, an ISO or RTO might run a KYC review if it learns through a press report that a market participant may be in distress (*e.g.*, laying off a significant number of employees, closing businesses, etc.). There is no prescriptive formula for

[13] The ISOs and RTOs satisfy part of this requirement through their affiliate disclosure rules.

[14] There are many vendors for such services (*e.g.*, LexisNexis, Actimize).

determining what must trigger such a review; the ISOs and RTOs have a fiduciary obligation to its members to review for and respond to significant news about any of its market participants with rational curiosity and follow up as warranted.

2. Participant Bans or Suspensions

MISO, PJM, NYISO and other ISOs and RTOs are exploring ways to limit a market participant's ability to trade in a market under certain circumstances. Some of the proposed limitations include: (i) a ban of a potential new entrant, existing member or individual; (ii) suspension of an existing member; or (iii) simply requesting onerous collateral that serves as the equivalent of a suspension. ETI recognizes this is a tricky issue and the ISO/RTO should have some discretion to stop bad actors or bad behavior. It is generally supportive of efforts to limit participation of a market participant that experiences a negative credit event or if they reach a position limit based on the most current credit assessment completed by an ISO or RTO, as discussed in Section II.A.1.b. of this petition. Affording the ISOs/RTOs this type of credit management discretion is important for mitigating default risk. Such a limit is not a complete bar to participation for a company or individual, but rather a form of "time-out" that may be prudent based on the facts and circumstances of the market participant in question.[15]

ETI notes that while suspensions serve the purpose of pausing to re-evaluate a market participant's creditworthiness, they cannot be the only solution for credit risk management. Suspending a market participant that has open positions would not, in isolation, avoid a default or risk to the market from those positions. In fact, such a

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[15] PJM limited for a short period the ability of GreenHat to buy more FTRs. *Report of the Independent Consultants on the GreenHat Default*, at 22 (dated Mar. 26, 2019) ("*Independent Report*"). This was reasonable at the time and arguably should have been left in place until GreenHat posted more credit support.

suspension could leave the market worse off as the ISO or RTO would be left to manage those positions. ISOs and RTOs should not be in the business of portfolio management. A better solution would be to ensure that the ISO or RTO has sufficient initial and variation margin to cover the exposure from the open positions held by the market participant and reserve the right to suspend a market participant if the facts and circumstances around the market participant's credit evaluation change. Suspension is an after-the-fact solution that can be an important feature of an ISO's/RTO's credit risk management but may not be the appropriate tool given the circumstances. ETI cannot stress enough that suspension rights should be secondary to an initial measure of protection provided through initial and variation margin to minimize the risk to the ISO/RTO markets in the first place. A market participant ban, if lawful, or suspension should be the very last step and should only be utilized in extreme circumstances. A far better approach is to ensure that a market participant has the financial strength and liquidity to manage its positions and the ISOs/RTOs have access to sufficient liquid sources of credit to manage the risk exposure.

ETI is also concerned about efforts that afford the ISOs and RTOs the ability to be able to ban market participants on a long-term or permanent basis based on prior enforcement actions. For example, MISO and PJM are currently evaluating steps they would need to take in order to request authorization to ban an existing market participant from participating in its markets under certain circumstances. ETI is unaware of a provision of the Federal Power Act ("FPA") that would give an ISO or RTO authority to ban a trader or market participant absent an agreement by a party to refrain from trading, as happens from time to time in settlements.[16] Nevertheless, the ISOs/RTOs are considering changes to their protocols that would allow them to deny, suspend or revoke trading privileges for parties that have been the subject of a regulatory inquiry or investigation. In order for the ISOs and RTOs to take this course of action, they would need to demonstrate that they have authority to do so under the FPA. They also would need to provide adequate due process before such a ban could take effect (*e.g.*, rights to challenge the basis for a ban, the ability to be heard and present evidence to an independent tribunal with expertise in the energy trading space, an express ability to appeal to the Commission).

The ISOs and RTOs also assume that a trading ban goes hand in hand with implementing KYC protocols. The most common hypothetical raised by the ISOs/RTOs in ETI's discussions with them is: if, in the course of conducting a KYC review, we learn by reading a settlement that a company or individual was a subject of a Commission investigation, we would need to take action to remove or ban the subject from our market to comply with KYC principles. This assumption violates our core constitutional tenant of innocent until proven guilty and could cause significant reputational and financial harm to that participant. ETI does not think a ban is the correct or only response to learning such information.[17] From a counterparty risk management perspective, the ISO or RTO might:

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[16] *See, e.g., City Power Mktg., LLC and K. Stephen Tsingas*, 160 FERC ¶ 61,013 (2017); *MISO Cinergy Hub Transactions*, 149 FERC ¶ 61,278 (2014). ETI understands that the Commission has authority to deny or suspend tariffs (*e.g.*, market-based rate authority if a seller cannot meet the standards). However, the Commission's authority is limited to what is in its authorizing statutes. *See, e.g.*, *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 8 (D.C. Cir. 2002) (noting that "FERC is a 'creature of statute,' having no constitutional or common law existence or authority, but only those authorities conferred upon it by Congress."); *Mich. v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001); *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) (recognizing that "an agency literally has no power to act ... unless and until Congress confers power upon it.").

[17] Settlements typically do not include admissions of guilt so they should not serve as the basis for a ban unless the parties to a settlement expressly agree to a ban.

(1) implement additional surveillance to monitor the company or individual's market activity; (2) add flags to credit profiles that would remind the ISO or RTO to conduct additional KYC activities before allowing the company or individual to increase their exposure; or (3) review the market participant's risk management and/or training materials for evidence of a commitment to effective risk management and compliance.

Finally, it is important to remember that investigations and compliance inquiries are not infrequent in the energy sector. The mere fact that an entity or individual was the subject of an inquiry does not mean the entity or individual did anything wrong. The same is true of entities that enter into a settlement agreement with the Commission. Entities often settle a matter because it is less disruptive to their business operations or more economical from a legal cost perspective, even when they believe they have done nothing wrong. Settlements without an admission of guilt are a business decision. This type of business decision is made in corporate America daily in private litigation. The ISOs and RTOs should not assume that recidivism is inevitable for any company or individual but instead should consider the particular facts and circumstances of each case, with the understanding that the facts and circumstances to be considered are limited to what is filed and issued in publicly available Commission dockets, and adopt KYC requirements appropriate for the particular market participant.[18]

[18] The other concern is that sound credit policies are not based on whether you think you are dealing with a good person. A credit manager's view of a whether a party has a nefarious or good intent is beside the point when assessing whether they are creditworthy. Good people default. Credit managers should be looking at data with an educated eye to determine whether a market participant can afford the positions it wants to put on, the risk of default if market fundamentals change once it has open positions, the amount of credit support it has posted and capitalization levels in case additional credit support is required.

3. Other KYC Tools

NYISO is proposing a credit questionnaire that would require a market participant to disclose investors, including passive investors, in direct contravention to the Commission's final rule in the connected entities proceeding.[19] It also would require disclosure of ongoing litigation and financial changes that are deemed material without defining a threshold for materiality. ETI believes the market would be better served if NYISO and all other ISOs and RTOs provided quantifiable standards for measuring materiality (*e.g.*, a measurable ratio or percentage change in a stated benchmark). Otherwise, the rule would create a compliance trap for market participants for failure to report something they did not think was material but that might, in hindsight, seem material to ISO/RTO personnel.

Further, in proposing the credit questionnaire as a solution to the GreenHat default, NYISO and other ISOs and RTOs miss a larger lesson, which is that PJM did not have sufficient internal processes or expertise to assess and respond to the growing risk from GreenHat's unsecured participation in its markets. ISOs and RTOs cannot count on bad actors to self-report and have to have the ability to review whatever information is made available to them to identify changes in a market participant's creditworthiness. The NYISO approach places the entire burden on market participants and does not hold the ISO responsible for conducting its own due diligence. This approach is not followed in any other commodity market.

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[19] *Data Collection for Analytics and Surveillance and Market-Based Rate Purposes*, 168 FERC ¶ 61,039, at P 226 (2019) (declining to require regulated entities to report trader and other natural person information).

C. Each ISO and RTO Should Have a Robust Risk Infrastructure

The technical conference and rulemaking that ETI is requesting should explore establishing the requirement that there be a Chief Risk Officer ("CRO") role and risk management department within each ISO/RTO. ETI strongly believes that each ISO/RTO should have a CRO that reports directly to the Board in order to maintain independence. A CRO should be evaluating different types of risk across the entire organization. Further, a CRO should have an entire team that works on KYC procedures, gets to know market participants and understand their businesses, and, thereby, be best situated to assess ongoing risk to the ISO/RTO based on new, incoming information concerning market participants or the market in general.

In addition to the CRO, the ISOs/RTOs need to have people who are properly trained in assessing credit and counterparty risk. One of the most troubling facts that came out of the GreenHat independent investigation report was that GreenHat was valuing its FTR portfolio as positive in its financial statements – and PJM accepted this valuation – when the mark-to-auction was $90 million negative.[20] PJM staff did not have the resources or the expertise to accurately review the financial statements provided by GreenHat.[21] Thus, the ongoing question within ISOs/RTOs as to whether to require audited financials in light of GreenHat are based on a faulty premise that the sole act of collecting financial statements will help to prevent defaults. Yet, GreenHat submitted audited financials, so requiring market participants to submit audited financial statements is clearly not a cure-all.[22] Instead, ISOs/RTOs need to have staff that can evaluate any

[20] *See, e.g.*, *Independent Report* at 18, 24.

[21] *See, e.g.*, *Independent Report* at 26.

[22] *See, e.g.*, *Independent Report* at 18.

financial statements provided as part of an initial credit review, and as part of ongoing counterparty risk assessments, ask the right questions about the information contained within financial statements and know what kind of credit support is needed based on the information presented in the financials, and the market participant's desired level of participation/exposure in the market.

To this end, ETI recommends that the requested rulemaking explore ongoing training requirements for ISO/RTO staff to ensure they have the proper knowledge and expertise to protect the market in terms of credit and counterparty risk management. Just as Order No. 741 requires market participants to have appropriate training and expertise in-house, ETI strongly believes that the Commission should explore similar standards for ISO/RTO staff.

Lastly, ETI agrees with proposals under discussion that would require audited financials and routine compliance checks of risk policies for market participants. However, ETI would take this a step further and require an audit of each ISO/RTO risk department by an independent third-party on an annual basis. Such independent evaluations would serve to highlight potential weaknesses and result in improvements to the ISOs/RTOs, as is evident from the internal review PJM had conducted in response to GreenHat. Such measures would ensure that the Commission-jurisdictional ISO/RTO markets remain best in class.

III. IDENTITY AND INTERESTS OF PETITIONERS

ETI represents a diverse group of energy market participants, all with substantial interests in wholesale electricity transactions in Commission-jurisdictional markets. ETI members provide important services to a wide variety of wholesale energy market participants. They act as intermediaries between producers and consumers of electric energy that have mismatched quantity, timing, and contract-type needs. In addition, they provide liquidity by engaging in energy-related commercial transactions with a variety of market entities including, but not limited to, generation owners, project developers, load-serving entities, and investors. ETI members advocate for markets that are open, transparent, competitive and fair – all necessary attributes for markets to ultimately benefit electricity consumers.

IV. CONCLUSION

ETI respectfully requests that the Commission schedule an initial technical conference by March 30, 2020 and initiate a rulemaking to revisit Order No. 741 and ISO/RTO credit and risk management practices to bring them up to date to ensure that current markets provide open access and are secure for market participants to transact. In addition, ETI also respectfully submits Appendix A, which suggests questions for discussion at the requested technical conference.

Respectfully submitted,

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APPENDIX A

A. Credit Risk Management

1. What basic principles should the Commission explore to guide establishing appropriate margin models and consistent credit requirements for each ISO/RTO?

2. How frequently should variation margin be assessed and are there associated market design changes that would aid in implementation of appropriate variation margin?

3. How frequently should financial information be reviewed by each ISO/RTO?

4. What guiding principles should the Commission explore to ensure consistency in capitalization requirements?

5. What guiding principles should the Commission explore to ensure consistency in risk policy review? Should one entity be created to review all risk policies for the ISOs/RTOs?

6. How should position limits be established by the ISOs/RTOs to reduce risk but maintain liquidity?

B. Counterparty Risk Management

1. What basic principles should the Commission explore to guide the ISOs and RTOs in establishing Know Your Customer (KYC) protocols?

2. What legal authority do ISOs/RTOs have to ban or suspend a new applicant or market participant?

3. What level of discretion should an ISO/RTO have to ban or suspend a market participant?

4. What due process should be afforded to a new entrant that is being rejected or an existing market participant that is being suspended?

C. ISO/RTO Internal Infrastructure and Training

1. What qualifications must a Chief Risk Officer have?

2. What should the reporting structure of a Chief Risk Officer be and why?

3. What expertise should a risk department within an ISO/RTO have and what monitoring/evaluation for that department is appropriate?

4. What training or certification is necessary and should be required of each ISO/RTO risk and credit staffer to stay current on industry best practices?

5. Are there additional resources that ISOs/RTOs need to adequately manage credit and counterparty risk?

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