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## Market Rule Amendment Proposal

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### PART 1 – MARKET RULE INFORMATION

Identification No.:	MR-00406		
Subject:	Prudential Support Obligations		
Title:	Prudential Support – Revisions to the Amounts for Credit Ratings, Good Payment History Reductions and Guarantees		
Nature of Proposal:	<input checked="" type="checkbox"/> Alteration	<input type="checkbox"/> Deletion	<input type="checkbox"/> Addition
Chapter:	2	Appendix:	
Sections:	Sections 5.7.4, 5.7.4A, 5.8.1, 5.8.1A, 5.8.4, 5.8.5		
Sub-sections proposed for amending:			

### PART 2 – PROPOSAL HISTORY

Version	Reason for Issuing	Version Date
1.0	Draft for Technical Panel review	October 15, 2013
2.0	Publish for Stakeholder Review and Comment	October 24, 2013
3.0	Submitted for Technical Panel Vote	November 26, 2013
4.0	Recommended by Technical Panel; Submitted for IESO Board Approval	December 3, 2013
Approved Amendment Publication Date:		
Approved Amendment Effective Date:		

### PART 3 – EXPLANATION FOR PROPOSED AMENDMENT

Provide a brief description of the following:

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

#### Summary

The IESO proposes to amend the market rules in order to increase the allowable unsecured credit for market participants to use in satisfying their prudential support obligations with the IESO.

Specifically, the amendments will increase:

- The allowable reductions to prudential support obligations available to those market participants with third party credit ratings from an acceptable bond rating agency;
- The allowable reductions to prudential support obligations based on a market participant's good payment history;
- Allowable amounts for guarantees which are based on the third party credit rating of an affiliate of a market participant.

This proposal is based on stakeholder consultation as part of SE-107 Prudential Review - 2013.

Further information on SE-107 can be found on the IESO's website at:

[http://www.ieso.ca/imoweb/consult/consult\\_se107.asp](http://www.ieso.ca/imoweb/consult/consult_se107.asp)

#### Background

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

The level of prudential support required from a market participant can be reduced by a participant's credit rating or good payment history. In addition, unsecured credit via a guarantee can be provided by a market participant to satisfy their prudential support obligation based on the credit rating of an affiliate of the market participant.

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

**PART 3 – EXPLANATION FOR PROPOSED AMENDMENT****Discussion**Affiliate Guarantees – Non-Local Distribution Companies (LDCs):

The following changes are proposed to section 5.7.4 of Chapter 2 to increase the maximum amount which may be guaranteed by an affiliate of a market participant who is a non-LDC:

- A-, A, A+ or equivalent; increase to:  
the greater of 90% (from 85%) of maximum net exposure or \$37.5 million (M) (from \$25M) of all market participants guaranteed by the affiliate;
- BBB-, BBB, BBB+ or equivalent; increase to:  
the greater of 65% (from 60%) of maximum net exposure or \$15M (from \$10M) of all market participants guaranteed by the affiliate;
- BB-, BB, BB+ or equivalent; increase to:  
the greater of 30% (from 25%) of maximum net exposure or \$4.5M (from \$3M) of all market participants guaranteed by the affiliate.

Affiliate Guarantees – LDCs:

The following changes are proposed to section 5.7.4A of Chapter 2 to increase the maximum amount which may be guaranteed by an affiliate of a market participant who is an LDC:

- A-, A, A+ or equivalent; increase to:  
the greater of 95% (from 90%) of maximum net exposure or \$45M (from \$30M) of all market participants guaranteed by the affiliate;
- BBB-, BBB, BBB+ or equivalent; increase to:  
the greater of 80% (from 75%) of maximum net exposure or \$22.5M (from \$15M) of all market participants guaranteed by the affiliate;
- BB-, BB, BB+ or equivalent; increase to:  
the greater of 55% (from 50%) of maximum net exposure or \$7.5M (from \$5M) of all market participants guaranteed by the affiliate.

No changes are required to the provisions related to guarantees for non-affiliates (e.g. section 5.7.2.2). Non-affiliate guarantee amounts are capped by section 5.7.3 of Chapter 2.

Reductions for Credit Ratings – Non-LDCs:

The following changes are proposed to section 5.8.1 of Chapter 2 to increase the prudential support reduction for a credit rating from an IESO approved bond rating agency for a market participant who is a non-LDC:

- A-, A, A+ or equivalent; increase to:  
the greater of 90% (from 85%) of maximum net exposure or \$37.5M (from \$25M);
- BBB-, BBB, BBB+ or equivalent; increase to:  
the greater of 65% (from 60%) of maximum net exposure or \$15M (from \$10M);
- BB-, BB, BB+ or equivalent; increase to:  
the greater of 30% (from 25%) of maximum net exposure or \$4.5M (from \$3M).

Reductions for Credit Ratings – LDCs:

The following changes are proposed to section 5.8.1A of Chapter 2 to increase the prudential support

**PART 3 – EXPLANATION FOR PROPOSED AMENDMENT**

reduction for a credit rating from an IESO approved bond rating agency for a market participant who is an LDC:

- A-, A, A+ or equivalent; increase to:  
the greater of 95% (from 90%) of maximum net exposure or \$45M (from \$30M);
- BBB-, BBB, BBB+ or equivalent; increase to:  
the greater of 80% (from 75%) of maximum net exposure or \$22.5M (from \$15M);
- BB-, BB, BB+ or equivalent; increase to:  
the greater of 55% (from 50%) of maximum net exposure or \$7.5M (from \$5M).

**Reductions for Good Payment History – Non-LDCs:**

The following changes are proposed to section 5.8.4 of Chapter 2 to increase the prudential support reductions based on the good payment history of a market participant who is a non-LDC:

- Six years or more; increase to:  
the lesser of 50% (from 40%) of maximum net exposure or \$12M (from \$6M);
- Five years; increase to:  
the lesser of 30% (from 25%) of maximum net exposure or \$7.5M (from \$5M);
- Four years; increase to:  
the lesser of 25% (from 20%) of maximum net exposure or \$6M (from \$4M);
- Three years; increase to:  
the lesser of 20% (from 15%) of maximum net exposure or \$4.5M (from \$3M);
- Two years; increase to:  
the lesser of 15% (from 10%) of maximum net exposure or \$3M (from \$2M).

**Reductions for Good Payment History – LDCs:**

The following changes are proposed to section 5.8.5 of Chapter 2 to increase the prudential support reductions based on the good payment history of a market participant who is an LDC:

- Six years or more; increase to:  
the lesser of 80% (from 70%) of maximum net exposure or \$14M (from \$7M);
- Five years; increase to:  
the lesser of 65% (from 60%) of maximum net exposure or \$9M (from \$6M);
- Four years; increase to:  
the lesser of 45% (from 40%) of maximum net exposure or \$7.5M (from \$5M);
- Three years; increase to:  
the lesser of 35% (from 30%) of maximum net exposure or \$6M (from \$4M);
- Two years; increase to:  
the lesser of 25% (from 20%) of maximum net exposure or \$4.5M (from \$3M).

**PART 4 – PROPOSED AMENDMENT****Chapter 2****5. Prudential Requirements**

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## 5.7 Obligation to Provide Prudential Support

5.7.4 For *market participants*, other than a *distributor*, 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;

Credit Rating Category of Affiliate using Standard and Poor's Rating Terminology	Maximum Amount which May be Guaranteed by Affiliate
AA- and above or equivalent	100% of <i>maximum net exposure</i> of all <i>market participants</i> guaranteed by <i>affiliate</i>
A-, A, A+ or equivalent	Greater of <del>85</del> 90% of <i>maximum net exposure</i> or <del>\$2537,95</del> 00,000 of all <i>market participants</i> guaranteed by <i>affiliate</i>
BBB-, BBB, BBB+ or equivalent	Greater of <del>65</del> 60% of <i>maximum net exposure</i> or <del>\$150,000,000</del> of all <i>market participants</i> guaranteed by <i>affiliate</i>
BB-, BB, BB+ or equivalent	Greater of <del>253</del> 30% of <i>maximum net exposure</i> or <del>\$34,05</del> 00,000 of all <i>market participants</i> guaranteed by <i>affiliate</i>
Below BB- or equivalent	0

5.7.4.A 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:

Credit Rating Category of Affiliate using Standard and Poor's Rating Terminology	Maximum Amount which May be Guaranteed by Affiliate
AA- and above or equivalent	100% of <i>maximum net exposure</i> of all <i>market participants</i> guaranteed by <i>affiliate</i>
A-, A, A+ or equivalent	Greater of <del>95</del> 90% of <i>maximum net exposure</i> or <del>\$3045,000,000</del> of all <i>market participants</i> guaranteed by <i>affiliate</i>
BBB-, BBB, BBB+ or equivalent	Greater of <del>758</del> 80% of <i>maximum net exposure</i> or <del>\$1522,05</del> 00,000 of all <i>market participants</i> guaranteed by <i>affiliate</i>
BB-, BB, BB+ or equivalent	Greater of <del>55</del> 50% of <i>maximum net exposure</i> or <del>\$57,05</del> 00,000 of all <i>market participants</i> guaranteed by <i>affiliate</i>

Below BB- or equivalent	0
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## 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 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*.

Credit Rating Category using Standard and Poor's Rating Terminology	Allowable Reduction in Prudential Support
AA- and above or equivalent	100% of <i>maximum net exposure</i>
A-, A, A+ or equivalent	Greater of <del>85</del> 90% of <i>maximum net exposure</i> or \$ <del>2537,05</del> 00,000
BBB-, BBB, BBB+ or equivalent	Greater of <del>65</del> 0% of <i>maximum net exposure</i> or \$ <del>150</del> ,000,000
BB-, BB, BB+ or equivalent	Greater of <del>25</del> 30% of <i>maximum net exposure</i> or \$ <del>34,05</del> 00,000
Below BB- or equivalent	0

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*.

Credit Rating Category using Standard and Poor's Rating Terminology	Allowable Reduction in Prudential Support
AA- and above or equivalent	100% of <i>maximum net exposure</i>
A-, A, A+ or equivalent	Greater of <del>95</del> 0% of <i>maximum net exposure</i> or \$ <del>3045</del> ,000,000
BBB-, BBB, BBB+ or equivalent	Greater of <del>75</del> 80% of <i>maximum net exposure</i> or \$ <del>1522,05</del> 00,000
BB-, BB, BB+ or equivalent	Greater of <del>55</del> 0% of <i>maximum net exposure</i> or \$ <del>57,05</del> 00,000
Below BB- or equivalent	0

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*, by an amount equal to the monetary value prescribed, by the table below:

Good Payment History Categories for Non-Distributors	Allowable Reduction in Prudential Support
≥6 years	Lesser of <del>45</del> 50% of <i>maximum net exposure</i> or \$ <del>612</del> ,000,000
≥5 years, <6 years	Lesser of <del>2530</del> 25% of <i>maximum net exposure</i> or \$ <del>57,05</del> 00,000
≥4, <5 years	Lesser of <del>259</del> 25% of <i>maximum net exposure</i> or \$ <del>46</del> ,000,000
≥3, <4 years	Lesser of <del>1520</del> 15% of <i>maximum net exposure</i> or \$ <del>34,05</del> 00,000
≥2, <3 years	Lesser of <del>159</del> 15% of <i>maximum net exposure</i> or \$ <del>23</del> ,000,000
<2 years	0

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:

Good Payment History Categories for Distributors	Allowable Reduction in Prudential Support
≥6 years	Lesser of <del>78</del> 78% of <i>maximum net exposure</i> or \$ <del>714</del> ,000,000
≥5 years, <6 years	Lesser of <del>659</del> 65% of <i>maximum net exposure</i> or \$ <del>69</del> ,000,000
≥4, <5 years	Lesser of <del>459</del> 45% of <i>maximum net exposure</i> or \$ <del>57,05</del> 00,000
≥3, <4 years	Lesser of <del>359</del> 35% of <i>maximum net exposure</i> or \$ <del>46</del> ,000,000
≥2, <3 years	Lesser of <del>259</del> 25% of <i>maximum net exposure</i> or \$ <del>34,05</del> 00,000
<2 years	0

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 licence 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*.

**PART 5 – IESO BOARD DECISION RATIONALE**

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