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Independent Electricity System Operator
1600-120 Adelaide Street West
Toronto, ON M5H 1T1
t 416.967.7474
www.ieso.ca

Memorandum

To: Stakeholder Advisory Committee

From: Terry Young, VP Policy, Engagement and Innovation

Date: August 11, 2020

Subject: IESO Business Update – Update on LDC Liquidity Concerns – Temporary Market Rule Exemption on default interest charges

The following provides an update to members of the Stakeholder Advisor Committee on the temporary Market Rule Exemption on default interest charges for all market participants that was approved by the IESO Board of Directors and went into effect on July 30, 2020.

Background

In the context of the COVID-19 pandemic and resulting likely systematic economic impact, market participants, including local distribution companies, expressed concern that they may not be timely in paying their IESO invoice(s), and asked the IESO for assistance in managing payment delays as well as relief from the "default interest rate" under the market rules.

- The market rules require the IESO to charge the "default interest rate" when market participants have not paid their invoices on time or in full.
- The default interest rate is the Canadian prime interest rate plus two per cent ("Prime + 2%", currently @ 4.45%), is generally an appropriate commercial interest rate in most business economic cycles, however, this is significantly higher than the (fluctuating) current costs to the IESO from having to borrow funds to meet any shortfall and settle the market.

Stakeholder Feedback and Reaction

The IESO conducted outreach with market participants to better understand financial issues and concerns related to COVID-19 impacts. Input from large consumers, local distribution companies (LDCs), and associations, helped the IESO understand their key and forecasted financial risks. This feedback informed the IESO's approach and Exemption Application.

Feedback from market participants are grouped into these themes:

Reduce financial impacts of late payments	The IESO cannot waive default interest charges as the IESO is required to charge interest to market participants in payment default at the Canadian prime interest rate plus 2%. The IESO can request relief by temporarily lowering the default interest rate.
Extend payment due dates	The IESO has the authority to work with each market participant (MP) on a case-by-case basis and may defer payment as long as the MP expects to be able to pay their obligations in full and IESO has sufficient MP collateral to manage the scale of this issue.
Eliminate collateral requirements	IESO cannot eliminate collateral requirements. IESO will only draw on collateral if the participant has no ability to pay outstanding obligations or has committed some other key event of default. Elimination of collateral requirements would require market rule changes and would expose the remaining MPs in the market to additional risk.

The IESO sought a temporary exemption from the "default interest rate" market rule to provide efficient and reasonable relief to the market:

- using the exemption process, rather than a full market rule change, brings about a faster response;
- temporarily changes the "default interest rate" to be applied at the IESO's borrowing costs versus the market rule of Prime + 2%;
- will be available to all market participants, as required; and
- aligns with the temporary nature of the pandemic and expires on January 1, 2022 or earlier upon notice from the IESO, if needed.

The IESO published the proposed exemption in June 2020 for market participant feedback. While no formal feedback was received, the IESO reached out to a number of stakeholders and no concerns were raised.

Impact of Exemption on Market Participants and the IESO-Administered Markets

The default interest would approximate the IESO's borrowing costs. For example, in June 2020, the IESO's cost of borrowing was equal to the Province of Ontario's cost plus 0.25%. In June, the IESO borrowed at 0.46%. Going forward, the IESO would have to add any compounding interest costs and draw timing impacts to calculate the overall IESO's borrowing costs.

This change to the interest rate will have no impacts on reliability, the IESO's ability to efficiently operate the electricity markets, and creates no material additional costs to market participants or the IESO.