

FTR Market Eligibility Proposal

FTR Credit Working Group
Meeting #8
August 05, 2008

FTR Market Eligibility

- Motivation: Without participant eligibility requirements there are no means to ensure credit worthiness of participant beyond ability to meet current margin requirement
- Requirement is meant to establish the FTR participant as a sophisticated trader having the financial ability (Quantitative) and trading expertise (Qualitative) to participate in the market
- A sound financial assurance policy for futures markets (FTRs) should combine capital adequacy with requirements for risk management systems for risk reduction and mitigation.
- Minimum capitalization criteria provides a safety buffer against events that may occur that are outside the expected range of events for which risk mitigation measures (i.e., collateral requirements) have been taken.

Evolution of FTR Eligibility Proposal

Meeting Date	Quantitative	Non-Compliance	Qualitative	Non-Compliance
05/08/08	A) Minimum TNW <ul style="list-style-type: none"> Hedger: \$1MM Speculator: \$10MM 	A) Margin Premium & Position Limits	A) Establish experience in trading & risk mgmnt Complete FTR Training	A) No FTR mkt access
05/23/08	A) Eligible Contract Participant (ECP)	A) Margin Premium & Position Limits	A) Establish experience in trading & risk mgmnt Complete FTR Training	A) No FTR mkt access
06/05/08	A) None (EPIC) B) ECP	A) N/A (EPIC) B) Margin Premium & Position Limits	A) None (EPIC) B) Complete FTR Training Pass FTR certification	A) N/A (EPIC) B) No FTR mkt access
06/26/08	A) Minimum TNW <ul style="list-style-type: none"> FTR participant: \$10MM May utilize guaranty 	A) Margin Premium & Position Limits	A) Complete FTR Training	A) No FTR mkt access
07/14/08	A) None (EPIC) B) Minimum TNW <ul style="list-style-type: none"> FTR Participant \$10MM May utilize guaranty 	A) N/A (EPIC) B) Margin Premium & Position Limits	A) None (EPIC) B) Complete FTR Training	A) N/A (EPIC) B) No FTR mkt access
8/05/08	A) None (EPIC) B) Same as C) (DC Energy) C) Minimum TNW <ul style="list-style-type: none"> FTR participant: \$10MM May utilize guaranty 	A) N/A (EPIC) B) No FTR market access (DC Energy) C) Margin Premium	A) Complete FTR Training (EPIC) B) Same as C) (DC Energy) C) Complete FTR Training	A) No FTR mkt access (EPIC) B) Same as C) (DC Energy) C) No FTR mkt access

Capitalization Criteria for FTR Market Participation Only

- Uniqueness of FTR market merits targeted application of requirement
 - Lengthy forward exposure (Up to 60 months w/ LTTR)
 - High price volatility (derived from congestion prices in the day-ahead market)
 - Lack of adequate market liquidity
 - Few players – total of 46 FTR holders (Jan – Jun '08)
 - High concentration of FTR ownership – 6 participants owned ~ 80% of FTR MWs in '08
 - No means to close-out forward positions
 - No forward price curve
- Only market ISO administers where suspension does not halt accrual of additional losses beyond a few days (notwithstanding PoLR risk)
- Market liquidity concerns introduce additional risks:
 - FTR holder retaining losing positions for atypically long periods increasing market risk
 - “Impact Cost” of unwinding positions into a shallow buyer pool

Proposed Approach

- Proposal A) Epic Proposal
 - No Minimum Capitalization requirement
- Proposal B) DC Energy
 - If a FTR Participant has TNW of less than \$10MM
 - then such participant will not be permitted to participate in the FTR market until such time as their TNW exceeds \$10MM.
 - If TNW falls below \$10MM threshold will not be required to liquidate open FTR positions, however, will not be permitted to transact in future auctions until TNW exceeds threshold.
 - Except in the case where such Participant seeks to liquidate held positions through the auction and/or secondary market
 - May utilize affiliate guaranty for purposes of establishing TNW value

Proposed Approach

- Proposal C) ISO-NE Proposal
 - If a FTR Participant has TNW of less than \$10MM
 - and that Participant's FTR FA Requirements are greater than 20% of its TNW,
 - then an FTR margin premium equal to 20% of the calculated FTR FA Requirements will be added to the Participant's collateral requirement.
 - May utilize affiliate guaranty for purposes of establishing TNW value
 - Affiliate guaranties payment / margin obligations of FTR participant
 - If guaranties are not permitted to meet FTR FA requirements then such guaranty may only be used to satisfy TNW thresholds
 - Affiliate guaranties used for this purpose would not require the same investment grade criteria as guaranties posted to meet Financial Assurance Policy obligations
 - TNW to be reported no less frequently than quarterly, no more frequently than monthly