UNITED STATES OF AMERICA
BEFORE THE
FEDERAL REGULATORY COMMISSION

RTO/ISO Credit Principles and Practices	)	
	)	**Docket Nos. AD21-6-000**
Request for Technical Conference and	)	**AD20-6-000**
Petition for Rulemaking	)	

POST-TECHNICAL CONFERENCE COMMENTS OF
THE NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

The New York Independent System Operator, Inc. ("NYISO") respectfully submits these comments in response to the Notice Inviting Post-Technical Conference Comments issued by the Federal Energy Regulatory Commission ("Commission" or "FERC") on April 21, 2021.[1] The NYISO appreciates the opportunity to provide additional commentary on the issues raised at the February 25-26, 2021 technical conference on principles and best practices for credit risk management. The NYISO has joined in the comments of the ISO/RTO Council ("IRC") addressing information sharing ("IRC Comments"). The IRC Comments reflect the NYISO's views on the Coordination and Information Sharing questions in the April Notice. These comments provide the NYISO's responses to the remaining questions in the April Notice. [2]

[1] *RTO/ISO Credit Principles and Practices*, Notice Inviting Post-Technical Conference Comments, Docket No. AD21-6-000, *et al*. (April 21, 2021) ("April Notice").

[2] Capitalized terms not otherwise defined herein shall have the meaning specified in the NYISO Market Administration and Control Area Services Tariff ("Services Tariff") and Open Access Transmission Tariff ("OATT").

RESPONSES TO POST-TECHNICAL CONFERENCE QUESTIONS

1. Know Your Customer (KYC) Protocols

a. How can RTOs/ISOs increase the effectiveness of KYC protocols? Could the RTO/ISO markets benefit from third-party provision of credit monitoring or financial assurance services to improve RTO/ISO KYC functions?

The NYISO performs its know-your-customer ("KYC") protocols and customer risk assessments using internal resources. As described in the Opening Remarks of Sheri Prevratil, filed in this proceeding,[3] to perform these functions the NYISO utilizes tools such as: (1) evaluating financial statements; (2) performing analyses such as the Financial Risk Assessment and Expected Default Frequency; (3) evaluating information required to be reported by the Services Tariff, such as notices of material adverse changes and notices of certain investigations that could have a material adverse impact on an entity's financial condition; and (4) evaluating responses to an annual credit questionnaire, which includes disclosure of relevant information such as investigations, fraud, litigation, sanctions, bankruptcies, the identity and experience of principals, participation in other RTOs/ISOs, access to funding, and corporate structure. Importantly, the NYISO maintains an open dialog with its Market Participants and actively seeks additional information and discussion regarding their financial condition. Such ongoing dialogue is critical to evaluating each entity's financial health and creditworthiness. As discussed in the IRC Comments, the ability for RTOs/ISOs to share Market Participant information with one another would increase the effectiveness of the NYISO's KYC protocols.

It is not apparent to the NYISO that it would benefit from third-party provision of credit monitoring or financial assurance services. First, the NYISO does not expect that any third-party

[3] *RTO/ISO Credit Principles and Practices*, Opening Remarks of Sheri Prevratil on Behalf of The New York Independent System Operator, Inc., Docket No. AD21-6-000, *et al*. (March 1, 2020) ("NYISO Opening Remarks").

service provider, should one be available, could or should provide all of the KYC and credit risk evaluation services currently provided by the NYISO directly. The NYISO credit analysts have an in-depth knowledge of each Market Participant and the unique features of the NYISO-administered markets, and maintain ongoing communications with Market Participants. In addition, the information needs of RTOs/ISOs are unique as compared with other entities that third-party vendors may support. For example, the NYISO obtains key credit information from energy industry publications and public utility commission filings and orders that standard KYC third-party providers may not use in their analyses. Moreover, each RTO/ISO has its own credit risk environment unique to the structure and operation of the markets it administers, which influences the analyses it performs as required by its unique tariff provisions. As a result, KYC protocols may differ among the RTOs/ISOs, which would make it challenging for a third-party vendor to effectively and accurately gather all of the information that would meet the requirements of each RTO/ISO. Given the specialized knowledge of NYISO personnel, the uniqueness of the RTO/ISO markets as compared with other industries, and the variation among the RTO/ISO markets, the NYISO does not envision that the quality of the services rendered by a third party would be comparable or superior to the credit monitoring activities currently undertaken by the NYISO.

Second, if a third-party vendor could be identified as qualified to perform some KYC functions, there are not likely to be cost savings resulting from engaging that third party. Overseeing and supporting any form of third-party services would require ongoing engagement with, and oversight of, the vendor, and potential ongoing engagement between the vendor and Market Participants. NYISO personnel would need to continue to perform many of the functions performed today, as well as evaluate information received from the third-party vendor and decide what actions to take in response to that information. Further, although there are entities that participate in multiple RTO/ISO markets, there are also entities that solely participate in the markets administered by a single RTO/ISO. In these instances, it would not be more efficient or cost effective to use a third-party vendor at the expense of all RTOs/ISOs. Accordingly, it is unclear that the engagement of a third-party vendor to perform KYC protocols would produce cost savings. Absent the identification of improved credit monitoring or material cost savings, it is unclear what benefit a third-party vendor could offer that would justify a change from the approach taken today.

> *b. Are there ways RTOs/ISOs can reduce the administrative or cost burden of KYC protocols on Market Participants while retaining or increasing their effectiveness? For example, would increased standardization of RTO/ISO KYC protocols improve their effectiveness and/or reduce Market Participant burden? Would standardization of the initial Market Participant application or the annual recertification process for Market Participants be beneficial?*

As noted above, there are differences in the markets administered by each RTO/ISO that result in unique information needs to ensure access to the correct data and information for assessing credit risk within the context of each market. Much of the information the NYISO gathers through its existing KYC protocols and during the customer application process is unique to the NYISO-administered markets, tariff requirements, and systems. For this reason, the NYISO questions whether it is feasible to standardize the initial Market Participant application across RTOs/ISOs. In addition, because RTOs/ISOs use different processes and technologies in their application processes, it is possible that attempting to implement standardization could result in significant costs to the extent such standardization entails material system and process changes. Such costs could potentially outweigh benefits in pursuing standardization, especially if an overly prescriptive "one size fits all" approach were pursued.

With respect to annual certifications, while some of the annual certification requirements are similar among some RTOs/ISOs, they are not identical, and RTOs/ISOs would need to continue to gather the information and certifications specific to their tariffs. The NYISO therefore questions whether standardization of annual certifications would reduce Market Participant administrative requirements.

As it has historically, the Commission should continue to recognize regional variations across the RTOs/ISOs and encourage each RTO/ISO to pursue any necessary enhancements in a manner appropriately tailored to the unique circumstances of its markets.

c. Should RTOs/ISOs have discretion to reject Market Participant applications, suspend market activity, or request additional collateral from a Market Participant based on information discovered during initial or periodic reviews of a Market Participant's risk? How should this discretion be implemented to provide transparency and clarity and to avoid undue discrimination?

It is critically important for RTOs/ISOs to have discretion and take appropriate actions in response to information evidencing an unreasonable credit risk to its markets, including the ability to reject applications or request additional collateral based on information that demonstrates that an entity poses an unreasonable credit risk to its markets. The Services Tariff currently provides the NYISO this discretion.[4] However, the Services Tariff provides reasonable safeguards to prevent abuses of such discretion. For example, the NYISO is required to provide the Market Participant or applicant with a written explanation of the reasons for its decision. The requirement to provide a written explanation offers an important safeguard against arbitrary or discriminatory decision-making by the NYISO. Furthermore, an applicant or Market Participant may seek redress at the Commission if it believes the NYISO's written explanation demonstrates that the NYISO has misapplied the tariff or engaged in unduly discriminatory conduct. Such

[4] Services Tariff Sections 9.3, 26.1.4, and 26.14.

safeguards ensure transparency and accountability in the NYISO's administration of creditworthiness requirements.

2. Minimum Capitalization Requirements

a. Are existing RTO/ISO minimum capitalization requirements sufficient to protect the markets without creating an undue burden on Market Participants? How, if at all, should minimum capitalization requirements differ for different types of Market Participants or market activity? Should minimum capitalization requirements be directly calibrated to the anticipated market activity of Market Participants? Should position limits be established based on a tiered approach to minimum capitalization requirements?

Minimum capitalization requirements are appropriate in RTO/ISO markets because well-capitalized Market Participants are less likely to default in the event of market volatility that may lead to unexpected losses, as they have more resources available to cover these losses than under-capitalized entities. However, appropriate balancing is warranted to avoid the imposition of excessive capitalization requirements that serve as an unreasonable barrier to participation in the market.

The Services Tariff requires that a Market Participant, or its guarantor, provide audited financial statements that show the entity has either \$10 million in assets or \$1 million in tangible net worth. If the financial statements do not meet this level, the entity can post \$200,000 in security (or, if the entity participates in the Transmission Congestion Contract ("TCC") market administered by the NYISO, the applicable minimum security requirement is set at \$500,000). In approving these requirements, the Commission found the NYISO's proposed minimum capitalization requirements to be consistent with thresholds in other markets, and that the collateral alternative "strikes a reasonable balance that accommodates smaller market participants that cannot meet the capitalization requirement, while protecting the markets from the risks posed by undercapitalized participants."[5]

The NYISO believes that its existing minimum capitalization requirements continue to be appropriate, balancing the need to require that entities be sufficiently capitalized to participate in the NYISO-administered markets with the need to avoid undue barriers to entry. Unnecessarily increasing minimum capitalization requirements could reduce market liquidity and provide a competitive advantage to larger Market Participants without materially reducing the risk of a default in the markets.

In the NYISO's view, credit requirements unique to the market activity undertaken by each entity provide the most effective means for addressing the unique risks presented by the participation of an entity in the NYISO-administered markets. Minimum capitalization requirements should be designed to provide a baseline level of reasonable assurance as to the financial capability of an entity for eligibility to participate in the NYISO-administered markets. The NYISO calculates unique credit requirements for each market administered by the NYISO in which a particular Market Participant is registered to participate. These requirements change based on the activity of Market Participants. Credit requirements appropriately calibrated to the risk of market activity naturally limit the ability of Market Participants to take highly risky positions because higher levels of credit will be required for more risky activity. Ensuring that credit requirements adequately reflect the risk associated with the relevant market activity is more likely to protect the market from default than blanket increases in minimum capitalization requirements.

[5] *New York Independent System Operator, Inc.*, Docket ER11-3949 *et al.*, Order on Compliance Filing paras. 42 and 43 (September 15, 2011).

3. Collateral Requirements

> *a. Do RTO/ISO collateral requirements appropriately scale with the risk of Market Participants' activity? If not, what are best principles and practices for estimating Market Participants' risk based on potential future exposure and for setting collateral requirements?*

Each RTO/ISO has its own unique characteristics and market designs. The NYISO's credit requirements align with its markets and are designed to scale with each Market Participant's activity. For example, in the NYISO-administered energy market, credit requirements adjust for shifts in price and/or volume. As such, during peak times when pricing levels may increase (*i.e*. hot weather periods during summer or cold weather conditions during winter) energy requirements may increase for a short period of time but then decrease as peak demand declines.

> *b. What is the appropriate amount of time for an RTO/ISO to hold collateral in order to protect the market from the risk of Market Participant default? Do any existing RTO/ISO practices inadvertently extend unsecured credit for financial transmission rights (FTR)?*

The NYISO has credit requirements calculated specifically for those Market Participants that withdraw from the markets.[6] These requirements ensure that these Market Participants remain adequately collateralized for all remaining financial obligations once they cease participation. The calculation projects future exposure throughout the true-up cycle and finalization of settlements for the activities undertaken by the Market Participant prior to exiting the markets and requires the Market Participant to provide secured credit for such exposure. Once all true-up charges are invoiced and paid, the credit requirement calculation will result in a requirement of zero and any remaining collateral will be returned to the former Market Participant.

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[6] Services Tariff Section 26.13.

None of NYISO's credit practices inadvertently extend unsecured credit for participation in the NYISO-administered TCC market.

c. Do RTO/ISO collateral requirements appropriately incorporate forward-looking price information? Would RTO/ISO collateral requirements benefit from incorporating more frequent mark-to-market updates? Would RTO/ISO collateral requirements benefit from incorporating future transmission changes? Should RTOs/ISOs that do not currently have alternative minimum collateral requirements for FTR portfolios consider them?

As noted in the NYISO Opening Remarks, to mitigate the risks associated with TCC market participation, the NYISO's credit policy establishes credit requirements for TCCs based on market-clearing prices set through TCC auctions, which are forward-looking and therefore provide a reliable predictor of future payments. In addition, the NYISO's policy re-prices TCCs frequently to capture changes in credit risk over time. Moreover, the Services Tariff requires Market Participants to post additional collateral or pay outstanding congestion rents if the net amount owed by the Market Participant for TCC congestion rents reaches 50% of the collateral posted by the Market Participant for its TCCs.[7] If the Market Participant does not satisfy the collateral requirement or make payment on their outstanding congestion rents by 4:00 pm on the day they are provided notice, the NYISO may cancel outstanding bids and suspend the Market Participant's ability to bid.[8]

The NYISO recently conducted a comprehensive evaluation of its current TCC auction practices and credit policy. From that review, the NYISO identified enhancements that were recently approved by FERC[9] and are expected to be deployed in October 2021. Importantly,

[7] Services Tariff Section 26.8.1.
[8] *Id.*
[9] *New York Independent System Operator, Inc. Proposed Tariff Provisions to Enhance TCC Credit Requirements*, Letter Order, Docket No. ER21-486 (January 12, 2021).

these enhancements result in consistent application of TCC credit policy over all TCC products, as appropriate, including the mark-to-market pricing of the second year of a two-year TCC.[10]

When the NYISO develops a new market design for any product, the NYISO collaborates internally to determine if there is any impact on credit policy. The Credit Department also collaborates with its external consultant when evaluating the performance of existing TCC credit policy. Recently the NYISO and its external credit policy consultant evaluated the potential for implementing a minimum alternative collateral requirement for the TCC market—specifically a $.15/MWH minimum threshold. The NYISO found that its existing Holding Requirement[11] calculation exceeds that minimum threshold in all cases reviewed.

d. How do current RTO/ISO collateral requirements account for extreme stress events, such as extreme weather, major changes in transmission or generation capacity, or shifts in energy prices? To the extent RTO/ISO collateral requirements do not account for the impact of extreme stress events, should they, and if so how? Should RTO/ISO collateral models be revised to reflect that extreme stress conditions may create temporarily high collateral requirements following such events? If so, how should RTO/ISO credit models be revised?

As noted previously, each RTO/ISO has its own unique system conditions and dynamics, as well as market design and characteristics. As such, accounting for extreme weather events in credit requirements is best addressed by each RTO/ISO in a manner that appropriately accounts for the conditions and circumstances present within its markets.

NYISO energy credit requirement calculations adjust for shifts in price and volume during extreme weather events. The NYISO engages in regular and ongoing communications with Market Participants during extreme weather events to identify potential risks that each entity may encounter with respect to satisfying requests for additional collateral and/or timely

[10] *New York Independent System Operator, Inc. Proposed Tariff Provisions to Enhance TCC Credit Requirements*, Filing Letter at 7, Docket No. ER21-486 (November 25, 2020).

[11] The Holding Requirement is the element of the TCC credit requirement that reflects market risk over time. Services Tariff Section 26.4.2.4.1.

and complete payment of invoices to the NYISO. If appropriate in certain extreme weather circumstances, the Services Tariff allows the NYISO discretion to change the amount of unsecured credit granted to a Market Participant or the amount of collateral required of a Market Participant if there is a material adverse change affecting the risk of nonpayment by the Market Participant.[12] The Services Tariff also provides the NYISO with the authority, if needed, to terminate or suspend a Market Participant in the event of a default.[13] Designing credit policies specific to extreme events may be costly and present an undue burden on Market Participants. Instead, the NYISO supports appropriately tailored credit requirements that adjust in response to the risks posed by such events when they arise and provisions of appropriate remedial measures in response thereto. The current credit requirements and remedial measures set forth in the Services Tariff are critical to protecting the NYISO-administered markets, while avoiding the imposition of unnecessary adverse impacts on Market Participants.

CONCLUSION

The NYISO provides the foregoing comments for the Commission's consideration as it evaluates future action on principles and best practices for credit risk management.

Respectfully submitted,

/s/ *Amie Jamieson*

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[12] Services Tariff Section 26.14.
[13] Services Tariff Section 7.5.3.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of Rule 2010 of the Rules of Practice and Procedure, 18 C.F.R. §385.2010.

Dated at Rensselaer, NY this 7th day of June 2021.

/s/ Joy A. Zimberlin

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