

Energy Forward Market

Prudential Discussion and Analysis
September 30 2008,



Agenda

1. Prudential overview
2. Impact of EFM type on prudentials
3. Which scenario is better?

IESO:

- Real Time market – post prudentials in accordance with market rules (rules evolved from loads & generators input)
- Physical Bi-laterals – potential to lower net prudentials
- Target is to have the right amount of prudentials posted without increasing unwarranted risk to the market nor excessive constraints on MPs' capital

External Parties / Exchanges:

- Target is to ensure there is almost no risk of under-collateralization
- Posting requirements are generally more aggressive (tighter time limits, closing of net positions, for-profit motivation)
- Clearinghouse (buyer and seller to every contract), therefore assumes risk of settlement, which is about ensuring its own liquidity

1. Today, an entity may trade in both IESO market and with external exchanges
 - Posting of prudential is done independently for each market
 - Financial vs. physical delivery type leads to different postings requirements
 - Liquidity of markets are different

2. Financial Contracts
 - Whether administered within IESO, or within a co-managed IESO and external exchange, these contracts are kept segregated from the physical delivery markets, therefore posting of prudentials will be independent.
 - If the IESO manages this in-house, there will be some advantages to MPs in conducting business within a consolidated operation.

3. EFM physical market – IESO only

- Able to leverage with the prudentials already posted,
- Generators will be able to take advantage of credit amounts owing to assist with their posting requirements
- Loads can benefit from having similar prudential requirements as for RT
- Control of market rules remains in the hands of the MPs and IESO for the benefit of the market as a whole

4. EFM physical market – external exchange & IESO

- Even if loads buy all power in EFM, a minimum amount of prudentials with IESO must be maintained
- Generators may need to post with external exchange and with IESO if they are net buyers in RT,
- IESO can allow exchange to draw on prudentials held by IESO, but this will increase risk to the IESO market, and therefore prudential design will have to be changed,

Which scenario is better?

There appears to be prudential advantages for:

- a physical contract (rather than financial swap), has more opportunities to co-mingle amounts
- IESO administered EFM (rather than external EFM), allows for consolidation of administration under one roof
- IESO has no incentive to make prudential postings burdensome, rather than the over-collateralization of external exchanges
- Key focus of IESO prudentials is to ensure the market has properly liquidity to satisfy transactions, not meant to be a business profit line (external exchanges)

- Questions,