DRAFT – FOR DISCUSSION ONLY (Feb-17-2018)

Note xx – Market Accounts

[NTD: existing narrative existing in Market Accounts note]

Financial Risk Management

The IESO is exposed to a number of financial risks as a result of its settlements of the electricity market. The IESO monitors and minimize adverse effects from these risks through its risk management processes.

a) Credit Risk – IESO's Market Accounts

Credit risk is the risk of financial loss due to the failure of a counterparty, IESO Market Participant, or party to honour their financial obligations.

(i) Securities: cash and cash equivalents, investments, and marketable securities
The IESO manages credit risk associated with securities through a management policy that limits securities to primarily investment-grade securities and securities' amounts with counterparty-specific limits. The management policy is approved by the Ontario's Minister of Energy.

Commented [ACM1]: See treasury policy

(ii) Receivables: trade and accounts receivables
The IESO manages credit risk associated with market account receivables with: a) collateral posted by Market Participants b) regular non-voluntary pre-payments and c) a default allocation process. Market Participants are required to post collateral based on their electricity market financial exposures as determined by the IESO. Market Participants are required to provide non-voluntary pre-payments to reduce their electricity financial exposures as determined by the IESO. If collateral is not sufficient to remedy a default amount, the IESO summons a default allocation process which recovers the default amount from all remaining non-defaulting Market Participants.

Commented [ACM2]: Chapter 2, section 8.

Commented [ACM3]: Chapter 2, aka margin calls

b) Market Risk – IESO's Market Accounts

Market risk is the risk of loss due to changes in market prices and rates, such as foreign exchange rates, interest rates, and equity prices. The IESO is primarily exposed to two types of market risk: currency risk and interest rate risk.

The IESO manages market risk through a management policy that limits securities to primarily investment-grade securities and securities' amounts with counterparty-specific limits. The management policy is approved by the Ontario's Minister of Energy.

i) Currency Risk

The IESO may conduct certain market account transactions in U.S. dollars, primarily related to vendors' payments. The IESO may utilize forward purchase contracts to purchase U.S. dollars for delivery at a specified date in the future at a fixed exchange rate. In addition, the IESO utilizes U.S. dollar spot rate purchases in order to satisfy any current accounts. As at December 31, 2017, the IESO did not have any outstanding forward purchase contracts for market accounts (December 31, 2016: $ nil).

ii) Interest Rate Risk

The IESO is exposed to movements or changes in interest rates primarily through its short-term variable rate credit facilities, and short-term securities or investments. The IESO market accounts does not currently utilize any fixed rate credit facilities or purchase any long-term investments.

The IESO utilizes its current credit facilities for draws generally of between 5 days to 95 days, in which the amounts may be subsequently renewed for another short-term period. All IESO's market account credit facilities have variable interest rates and therefore the IESO is exposed to changes in interest rates.

Commented [ACM4]:
Only:
TD Bank $150MM
OFA : $2B Fair hydro, and $475MM general

An IESO management policy approved by the Ontario's Minister of Energy does not permit the IESO to hold securities with maturities of more than 365 days.

iii) Equity Risk

The IESO's market account does not have any equity risk.

c) Liquidity Risk – IESO's Market Accounts

Liquidity risk is the risk of loss due to the inability of the IESO to meet its financial obligations when due. The IESO manages liquidity risk by forecasting cash flows to identify cash flows and financing requirements.

i) Market Settlements

In cases where a Market Participant fails to pay, the IESO may utilize credit facilities to settle the market. If the IESO has exhausted its credit facilities availability then the IESO may pay creditors on a pro rata basis in proportion to the amounts owed to each market creditor.

Commented [ACM5]: Chapter 9, 6.14.4

Commented [ACM6]: Chapter 9, 6.14.7

ii) Fair Hydro – regulatory asset

In accordance with the Ontario Fair Hydro Plan Act,

- the IESO will establish a regulatory asset based upon the IESO utilizing its credit facilities to fund a) the portion of the commodity price of electricity which is being deferred to future periods, b) the associated direct interest costs with the program, and c) the transferred asset's carrying costs up to July 2021; and
- the IESO is permitted to: a) transfer all or portion of the asset to a third party entity, and b) fully recover any non-transferred asset in a future period after May 2021 and subject to the Ontario Energy Board rates approval of the full recovery.

It is forecasted that that the IESO will incur more than $20 billion of funding between May 2018 and April 2047. The IESO has a current $2 billion line of credit with the Ontario Financing Authority (see Debt Note 7) with a maturity date of September 30, 2022 to fund these amounts. The third party entity is not obligated to purchase any transfer(s) offered by the IESO, and therefore the IESO is subject to liquidity risk.

Given the overall public importance of the Ontario Fair Hydro Plan Act, if the IESO should have any material liquidity event(s) the IESO expects either a) to increase the line of credit with the Ontario Financing Authority; b) the Ontario government to provide tax-based funding c) the Ontario government or Ontario Energy Board to make appropriate changes to the fair hydro program or rates; d) to seek reasonable substitute commercial lines of credit from other financial institutions, or e) any combination of the above.