Western Power Trading Forum Comments on Credit Requirements for Convergence Bidding

WPTF offers the following comments on the CAISO’s September presentation on credit requirements for convergence bidding.

There remains enough time prior to the target implementation date for convergence bidding to design a commercially viable, robust process for monitoring participant credit limits that protects the financial integrity of all CAISO markets. Other organized electricity markets around the US provide many examples from which the CAISO and stakeholders can learn, but it makes no sense to copy the practices of others blindly, especially when those practices fail to properly account for market risks. The CAISO should also draw from examples in organized markets other than electricity, where the commercial feasibility of any credit policy as it affects market participants is balanced against the risk borne by the financial clearing party. The CAISO’s credit policies with respect to its existing markets represent a compromise that imposes reasonable credit costs on market participants while protecting market participants from all but the most impossibly of default scenarios.

Modern systems for monitoring credit are capable of continuously assessing the state of a participant’s credit and its trading positions. They allow the financial clearing entity and the market participant to determine when financial security falls below acceptable limits. They rely on more sophisticated, probabilistic measures like Value at Risk rather than crude, deterministic proxies that impose unnecessary costs and inhibit liquidity. The No matter how the policy is structured, the CAISO and market participants should have up-to-the-minute information.

With respect to the specific structure of any credit policy, the CAISO should reconsider its initial proposal to have a bid reservation that includes a fixed Daily Virtual Trading limit. Trading volume is not an accurate indicator of the financial risk associated with a trading position. Similarly, the CAISO’s proposal to use the absolute value of offsetting supply and demand bids fails to reflect the financial impact of a entire trading position. Any credit policy should either employ “reference prices” that reasonably reflect expected values, or preferably use a stochastic approach to derive value at risk. These methods are used by financial houses, require relatively modest levels of computational effort and could be updated several times each day to reflect changes in market conditions.

Lastly, the CAISO should not limit its design for credit requirements and monitoring by assuming all convergence bidding will take place at Load Aggregation Points (LAPS). Convergence bidding will ultimately take place at many points in the grid, and any credit process should be designed with that ultimate objective in mind.
WPTF encourages the CAISO to “go back to the drawing board” on its convergence bidding credit policy approach. With a more market-focused approach that reflects risk, we expect there will be significantly more interest and specific feedback from stakeholders. We would be pleased to assist in the further development of the Convergence Bidding credit policy.

Thank you for your consideration.