



# MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

*Rely on us.*

TO: Commissioners Simpson, Brown, Helgeson, Manning and Mital  
FROM: Sue Fahey, Finance Manager and Anna Wade, Lead Financial Analyst  
DATE: April 25, 2016  
SUBJECT: Update to Board Policy SD8, Revised Power Risk Management Policies  
OBJECTIVE: Board Feedback

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## Issue

As part of the regular cycle of policy revisions, staff has reviewed the Power Risk Management Policy and is recommending revisions. SD8 was previously revised in October 2012. Staff is asking for Board feedback on the proposed revisions and intends to bring back the policy for approval at the June 7, 2016 meeting.

## Background

Board Policy SD8 was developed to create a framework for oversight control and guidance to the power trading operations. SD8 compliance limits have remained relatively static over time. Meanwhile, market factors including price, products, participants and standard practice are ever-changing. For example, trades executed prior to the financial crisis carried far greater exposure and risk than those executed today at depressed market rates. Additionally, staffing changes within EWEB have changed the way work is managed and authorized.

## Discussion

Staff have developed an update to SD8 that 1) provides a clearer strategic direction and scope of responsibility and; 2) delegates the oversight and management of risk targets to the Power Risk Management Committee (RMC), ensuring conformance with the risk tolerances and financial objectives set forth by the Board.

Specific amendments that are recommended for adoption by the Board are:

- **Generally** – Formalize the scope of risk and specific activities that are the responsibility of the RMC rather than the specific measures to be applied.
- **RMC committee membership** – Limit specificity of RMC representatives to provide for greater adaptability to changes in management and organizational structure.
- **Transaction Authority** – Individual transactions for Board approval have been revised to account for the economic value and risk associated with a diverse range of portfolio management strategies.

- **Compliance Measures** – Compliance limits currently existing in SD8 are also embedded within the Energy Risk Management Procedures. Internal procedures more specifically dictate the methodology for calculating portfolio risk and are therefore a more effective limitation to trade activity and position management.
- **Transparency** – Maintain transparency of RMC compliance with Board direction by means of annual reporting under SD8, quarterly financial reporting as well as notification of any RMC action that results in material changes to compliance limits defined within the Energy Risk Management Procedures.
- **Financial Limitations** – Align Board direction provided by Financial Policies (SD6) which includes setting reserve targets and transfers as well as the Enterprise Risk Management Policy (SD20) with the power risk measures and financial models in SD8.

### **Recommendation and Requested Board Action**

Staff is requesting feedback on the revised policy and based on that feedback will provide the revised policy and resolution for approval at the June 7, 2015 meeting.

**Policy Number:** SD8  
**Policy Type:** Strategic Direction  
**Policy Title:** Power Risk Management Policies  
**Date Approved** October 2, 2012 DRAFT

### Formation of Power Risk Management Committee

A Power Risk Management Committee (RMC) will be established to protect the organization from financial instability and unacceptable risk relating to market price volatility and counterparty performance, and to provide oversight control and reasonable assurance that contribution margin, as established in the Long Term Financial Plan, required to support Board strategic financial direction and policies, is achieved. This SD8 is made in consideration of the guidance to the trading operation provided in EWEB's SD6 Financial Policies and SD20 Enterprise Risk Management Policy, as set forth by the Board.

The RMC will be ~~comprised of~~ established as a horizontal team including the General Manager, ~~Assistant General Manager, Finance Manager,~~ as well as representatives from Power Resources & Strategic Planning Manager, Trading/Power Operations Manager, Fiscal, Financial Services Supervisor, Power Planning and the Generation & Fleet Services Manager. As a practical matter, minor title and/or work scope changes affecting RMC along with other members shall not require formal amendment to this policy of EWEB Management as may be appropriate.

~~This committee, which will meet as necessary, The RMC will be responsible to the Board of Commissioners for prudent implementation for oversight of these policies and oversight of the trading operation to ensure compliance with this policy and overall good industry practices compliance with SD8.~~ On at least an annual basis or as necessary, the ~~Financial Services~~ Finance Manager will present a report to the Board, covering the trading and contracting compliance with this policy ~~and the~~.

The Board shall retain approval authority for fixed price transactions greater than 1 year in duration and exceeding \$3 million in nominal value. Board approval shall also be required for generation asset sales or purchases, regardless of financial impact.

Specific responsibilities of the RMC include:

1. Ensure compliance with this policy and anti-speculation statutes and that risk management objectives relating to power management activities, tolerances and limits are achieved and adhered to.
2. Establish and maintain Power Risk Management Procedures which shall set forth compliance limits, reporting and controls requirements, operational guidance, approved market products, locations, transaction authority, counterparty credit and any other measures which may be required to ensure adherence to this policy.
3. Notify the Board of changes to compliance limits as defined within Power Risk Management Procedures.
4. Oversee power risk management control infrastructure and monitor compliance with the Power Risk Management Procedures.

- ~~4.5. Authorize and monitor risk reports for financial results obtained. Detailed responsibilities of the RMC include: market positions and credit exposure and direct staff to take mitigating action as necessary.~~
- ~~2. Oversee the approval of all wholesale power trading accounts and counterparties to insure creditworthiness.~~
- ~~3. Establish and periodically review the exposure and trading limits for trading operations, which shall not exceed the overall trading limits established by this Policy Statement.~~
- ~~4. Authorize physical and financial wholesale power trading representatives to conduct trades pursuant to this policy.~~
- ~~5. Review and approve (as appropriate), contracts which impact EWEB's power portfolio including, but not limited to, asset sales and purchases, power sales and purchases and retail contracts that are not pre-approved products or subject to traditional retail published tariffs.~~

#### ~~1. Compliance with Anti-speculation Statutes~~

~~EWEB must comply with ORS statutes stipulating the appropriate scope of investments for "surplus funds." Accordingly, EWEB's activities in the power markets must be associated with the provision of electricity to meet anticipated sales and generation forecasts. These criteria will be applied:~~

##### ~~Real Time (a 24 hour day)~~

~~EWEB will manage its Real Time position so that its exposure to market prices for the balance of the day is no greater than 50 average megawatts surplus or deficit.~~

##### ~~Short Term (balance of month and following month)~~

~~EWEB will manage its Short Term position so that its exposure to market prices, for the balance of the month and the following month is no greater than 75 average megawatts surplus or deficit.~~

##### ~~Mid Term (period beyond short term)~~

~~EWEB will manage its Mid Term position so that firm power supplies are within 25 average megawatts of expected firm sales.~~

~~This criteria will be applied to Mid Term time periods beyond the short term:~~

- ~~• For each month within the current and next prompt quarter~~
- ~~• For each of the next three quarters~~
- ~~• For each year within the next three years~~

~~The Board may grant exception to this policy to deal compliance with specific circumstances, such as long term resource acquisitions.~~

#### ~~2. Financial Exposure Limitation~~

In addition to the megawatt position limits set forth in the Compliance with Anti-Speculation Statutes policy above, EWEB will implement additional controls to further limit financial risk associated with its market positions. The function of these additional controls would be to ensure that EWEB's projected contribution margin, when combined with available reserves and borrowing authority, will provide funding capabilities to cover other budgeted/projected expenditures at the Electric Utility.

#### **Real Time (a 24 hour day)**

Because total volumes and resulting exposure is small, no financial exposure limits are required.

#### **Short Term (balance of month and following month)**

EWEB will manage its Short Term position such that there is a 95% probability an adverse market price movement will result in no more than a \$2 million risk exposure. The Board delegates the setting of methodologies for determining financial risk to be used to the Risk Management Committee.

#### **All Traded Periods**

At least on a monthly basis, Fiscal Services with the assistance of Power Operations and General Accounting will monitor the contribution margin and resulting impact on reserves and available borrowing authority for each month over the succeeding 18 to 36 months. In addition, a probability analysis will be conducted. The target is to have a contribution margin which when combined with available Power Reserve/Unallocated Power Fund and borrowing authority will meet or exceed the funding needs of the Electric Utility in each month with at least 90 percent probability and leave an appropriate safety margin. Currently, that safety margin is determined to be at least \$20 million. Subject to annual review, the contribution margin is calculated by summing wholesale, retail and service revenue from the trading floor and subtracting purchased power, transmission and generation costs, as well as CILT expense. The RMC may establish tighter exposure limits to effectively manage the overall position.

### **3. Development of Detailed Control Procedures**

Consistent with Committee of Chief Risk Officers Risk Policies, detailed control procedures will be developed by EWEB and approved by the RMC. These procedures will incorporate strong dual controls between those groups initiating trades and the risk management/accounting functions.

The Policy and Procedures Guide will further establish the roles and responsibilities of the trading group, accounting personnel, and risk staff. The detailed policies and procedures will incorporate a credit approval and monitoring process to manage and measure credit exposure. The Policy and Procedures Guide, and its inherent controls will be approved by the RMC and reviewed on an ongoing basis.

### **4. Authorized Activities**

The following types of price risk management instruments/transactions are authorized for trading activities:

- ~~Physical delivery contracts with a term up to and including one year.~~
  - ~~Financial agreements with approved counterparties with a term up to and including one year.~~
6. ~~The Policy and~~this policy and the Power Risk Management Procedures Guide as approved by the RMC will specify a process for determining the appropriate use of physical and financial hedge instruments. ~~The Guide will also stipulate the types of swaps and options approved for use by the trading operation. The list of approved products and appropriate uses will likely change as the market changes and EWEB's trading operation gains experience with their use.~~

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The RMC will be established as a horizontal team including the General Manager as well as representatives from Power Operations, Financial Services, Power Planning and Generation along with other members of EWEB Management as may be appropriate.

The RMC will be responsible for oversight of compliance with SD8. On at least an annual basis or as necessary, the Finance Manager will present a report to the Board, covering trading and contracting compliance with this policy.

The Board shall retain approval authority for fixed price transactions greater than 1 year in duration and exceeding \$3 million in nominal value. Board approval shall also be required for generation asset sales or purchases, regardless of financial impact.

Specific responsibilities of the RMC include:

1. Ensure compliance with this policy and anti-speculation statutes and that risk management objectives relating to power management activities, tolerances and limits are achieved and adhered to.
2. Establish and maintain Power Risk Management Procedures which shall set forth compliance limits, reporting and controls requirements, operational guidance, approved market products, locations, transaction authority, counterparty credit and any other measures which may be required to ensure adherence to this policy.
3. Notify the Board of changes to compliance limits as defined within Power Risk Management Procedures.
4. Oversee power risk management control infrastructure and monitor compliance with the Power Risk Management Procedures.
5. Authorize and monitor risk reports for financial results, market positions and credit exposure and direct staff to take mitigating action as necessary.
6. Review and approve (as appropriate), contracts which impact EWEB's power portfolio including, but not limited to, asset sales and purchases, power sales and purchases and retail contracts that are not pre-approved products or subject to published tariffs, for compliance with this policy and the Power Risk Management Procedures.