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**The Electric Reliability Council of Texas, Inc.**

		<b>POLICY NO. 2-</b> _____
<b>INVESTMENT POLICY</b>	<b>Effective Date:</b> September 1, 2004	<b>Revised:</b> August, 2004

**POLICY**

The purpose of the ERCOT Investment Policy is to provide written guidelines, approved by the ERCOT Board of Directors, for the investment and management of funds held by ERCOT and related activities.

It is the policy of ERCOT to invest its funds in a manner that provides reasonable investment returns with adequate security while meeting daily cash flow demands and conforming to applicable laws, Bylaws, board resolutions and policies and debt covenants.

**Scope.** The policy applies to activity involving ERCOT funds, except for the ERCOT Money Purchase Plan and the ERCOT 401(k) Plan, which are managed separately.

ERCOT funds specifically include proceeds from 1) the ERCOT system administration fee, 2) transmission congestion rights (TCRs) auctions, 3) market settlement operations, 4) security deposits, 5) debt issues and 6) other miscellaneous cash received.

**Standard of Care.** ERCOT investments will be made with judgment and care, under circumstances then prevailing, that persons of prudence, discretion and intelligence would exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of principal as well as the probable income to be derived.

The standard of prudence to be used by the Designated Investment Officers (defined below) shall be the “prudent person” and/or “prudent investor” standard and shall be applied in the context of managing an overall portfolio. The Designated Investment Officers of ERCOT acting in accordance with this policy and any other written procedures pertaining to the administration and management of ERCOT’s portfolio and who exercise the proper due diligence shall be relieved of personal responsibility for an individual security’s credit risk or market price changes.

**Investment Objectives.** The primary objectives, in priority order, of ERCOT’s investment activities shall be:

- A. Safety – Safety of principal is the foremost objective of the investment program. Investment of ERCOT funds will be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, ERCOT will diversify its investments by investing funds among a variety of securities offering independent returns and a variety of independent financial institutions.

B. Liquidity – ERCOT's investment portfolio will remain sufficiently liquid to enable ERCOT to meet all operating requirements which might be reasonably anticipated.

C. Return on investment – ERCOT's investment portfolio will be designed with the objective of attaining a benchmark rate of return throughout budgetary and economic cycles, in line with ERCOT's investment risk constraints and the cash flow characteristics of the portfolio.

**Delegation of Authority.** Responsibility for the investment program is hereby delegated to the Designated Investment Officers. The Chief Financial Officer and the Treasurer of ERCOT are the Designated Investment Officers of ERCOT and are authorized to enter into and are responsible for all investment transactions undertaken. They will establish a system of controls over the investment program.

The Designated Investment Officers will establish written investment procedures for the operation of the investment program consistent with this policy. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Designated Investment Officers.

Any two of the following officers, with at least one being a Designated Investment Officer shall have authority to open and close investment and / or depository accounts with Qualified Institutions (as defined below): Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, General Counsel, Controller and Treasurer.

**Qualified Institutions.** A Designated Investment Officer will select banks and other financial institutions that are approved for investment and / or depository purposes ("Qualified Institutions"). Only firms meeting the requirements of the attached Appendix A will be eligible to serve as Qualified Institutions.

If an ERCOT Board member or member of his or her immediate family is an officer or director or owns or has a beneficial interest in more than 10 percent of the stock in a bank or other financial institution that would otherwise be a Qualified Institution, such Board member shall provide full disclosure of such stock holdings or relationship in documented form to be filed with permanent records of ERCOT. Any institutions so disclosed will be excluded from consideration as a Qualified Institution without 1) full disclosure to the Board of Directors of the relationship and 2) and approval of the Board to establish the relationship.

**Authorized Instruments.** ERCOT shall invest only in those types of instruments authorized under this policy and listed in Appendix C and subject to the restrictions included in Appendix C.

**Safekeeping of Investments.** Security transactions, including collateral for repurchase agreements, will be conducted on a "delivery-versus-payment" (DVP) basis. Securities, other than shares in money market mutual funds, will be held in safekeeping, in the name of ERCOT, by a custodian (an independent state or federally-chartered bank) designated by the Treasurer and evidenced by safekeeping receipts. Institutions that

offer money market mutual funds are responsible for safeguarding their underlying securities.

**Internal Control.** The Treasurer shall ensure that the internal controls over investments are reviewed 1) periodically by ERCOT's internal auditor and 2) annually in conjunction with the fiscal audit by the external auditor. This review will test compliance with policies and procedures.

**Reporting.** A Designated Investment Officer will provide quarterly investment reports to the Board of Directors and Finance and Audit Committee which provide a clear picture of the status of the current investment portfolio.

Schedules in the quarterly report will, at a minimum, include the following:

- A listing of individual securities held at the end of the reporting period by authorized investment category
- Average life and final maturity of all investments listed
- Coupon, discount or earnings rate
- Par value, amortized book value and market value
- Percentage of the portfolio represented by each investment category
- Statement of compliance with the Investment Policy

**Investment Policy Adoption.** ERCOT's investment policy will be adopted by resolution of the Board of Directors. The policy will be reviewed annually by the Finance and Audit Committee and any modifications made thereto must be approved by the Board of Directors.

**Reviewed and Revised:** September 1, 2004

**Initial Effective Date:** August 1, 2002

## APPENDIX A

### Requirements of Qualified Institutions

Only entities meeting the following requirements will be eligible to serve as Qualified Institutions:

#### General Requirements

- The entity has a senior debt rating which is at least the equivalent of A- by Standard & Poor's or A3 by Moody's Investor Service,
- Has provided a current audited financial statement which is on file at ERCOT,
- Has capital of not less than \$100 million, and
- Has assets of not less than \$1 billion.

#### Additional Requirements for Depositories

- The entity is a federal- or state-chartered bank
- Deposits up to \$100,000 are insured by federal agencies

#### Additional Requirements for Security Dealers

- The entity is a "primary" or regional dealer that qualifies under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule),
- Is registered as a dealer under the Securities Exchange Act of 1934,
- Is a member in good standing of the National Association of Securities Dealers (NASD),
- The entity has been in business for at least five (5) years,
- A representative of the entity has returned a signed certification (substantially in the form attached as Appendix B) that he/she has read and is familiar with ERCOT's Investment Policy
- The entity has provided such other information as ERCOT requires from time to time.

## APPENDIX B

### Investment Policy for Electric Reliability Council of Texas

#### Qualified Institution Certification for Security Dealers

**Dealer / Investment Firm:** \_\_\_\_\_

I hereby certify that I have received and thoroughly reviewed the ERCOT Investment Policy, and the firm I represent

- 1) meets all of ERCOT's Requirements for Qualified Institutions; and
- 2) has implemented reasonable procedures and controls in an effort to preclude investment transactions between this firm and ERCOT that are not authorized by the ERCOT Investment Policy, except to the extent that this authorization is dependent on an analysis of the makeup of ERCOT's entire portfolio or requires an interpretation of subjective investment standards.

\_\_\_\_\_  
Qualified Representative

\_\_\_\_\_  
Name

\_\_\_\_\_  
Title

\_\_\_\_\_  
Date

## APPENDIX C

### Authorized Instruments

<u>Description</u>	<u>Quality Limitation</u>	<u>Maturity Limitation</u> (Note 1)	<u>Limitation per issuer</u>	<u>Category limitation</u>
1. Obligations of or guaranteed by the US government	n/a	5 yrs or less	none	none
2. Obligations of or guaranteed by other US governmental entities (e.g. federal agencies, state or municipal, etc)	n/a	5 yr or less	\$ 5,000,000	50% of total
3. Certificates of deposit and share certificates	Note 2	1 yr or less	\$ 5,000,000	33% of total
4. Repurchase agreements in which the collateral is government or agency securities (1 or 2 above). (Note 3)	Note 2	7 days or less	\$ 5,000,000	33% of total
5. Commercial paper	A1/P1 or better	1 yr or less	\$ 5,000,000	33% of total
6. Banker's acceptances	Note 2	1 yr or less	\$ 5,000,000	33% of total
7. Money market mutual funds (MMMF)	Note 4	Note 4	Note 4	none

Note 1: To the extent possible, ERCOT will attempt to match its investments with anticipated cash flow requirements. A base level of cash may remain uninvested to meet the operating needs of ERCOT.

Note 2: Investments may be made with financial institutions with a corporate or senior debt credit rating of at least A- with S&P or A3 with Moody's. Investments in repurchase agreements must be subject to a Master Repurchase Agreement signed with the bank or dealer (e.g. a PSA Master Repurchase Agreement or equivalent).

Note 3: Collateral is required for all repurchase agreements. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be 102% of market value and accrued interest. Collateral may consist only of other instruments approved above. Collateral will always be held by an independent third party with whom ERCOT has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to and retained by ERCOT. The right of collateral substitution is granted.

Note 4: There is no credit rating required given 1) the MMMFs stated objective to preserve capital, 2) the credit quality restrictions placed on MMMFs by the SEC (may hold no more than 5% of middle-rated securities - A2/P2 or equivalent), 3) the SEC restriction that no more than 5% of assets in a MMMF may be invested in any one security (requires diversification) and 4) the restriction that MMMFs can only invest in instruments with maturities of less than 13 months and that the average maturity of all holdings in a MMMF cannot extend beyond 90 days. There is no maturity limitation or limitation per issuer for the reasons mentioned above.