

# **Board of Directors**

**November 14, 2006**

**Credit Update and Proposed Next Steps**

# Credit objectives for the ERCOT market

- **Provide a financially stable market**
  - Residual credit risk should not endanger the overall financial stability of the market
- **Ensure transparency of potential market participant financial risks associated with residual credit exposure**
  - Credit risk is present in the ERCOT market
  - Mass transition losses (magnitude described herein)
- **Address new credit risks as they are identified**

# Significant improvements to date

Numerous improvements have been made including:

- Mass Transition timeline reduced from about 22 days to approximately 15 days
  - By June 2007 an additional 5 days will be cut
- PRR 625 increased notice period for QSE dropping an LSE from 5 business days to 12 business days (effectively collateral)
- PRR 568 reduces settlement date from 17 to 10 days after operating day
- PRR 638 changes the settlement invoice due date from 16 calendar days to 5 business days
- PRR 643 reduces the number of days allowed to cure a breach from 3 days to 2 days

# Significant reductions in exposure

## Potential loss in exit scenarios

### Potential loss (simplified – w / 3 weeks of collateral) (in 000's)

	<u>Previous</u>	<u>Today</u>	<u>2Q 2007</u>
<b>Approx number of days for process</b>	<b>22-26</b>	<b>15-17</b>	<b>10-12</b>
Collateral held <sup>(1)</sup>			
<b>1,000 MWh/day x \$100/MWh =</b>	<b>\$ 140</b>	<b>\$ 210</b>	<b>\$ 210</b>
<b>x 10% x 21 days</b>			
At default			
<b>1,000 MWh/day x \$100/MWh =</b>	<b><u>\$ 2,200</u></b>	<b><u>\$ 1,500</u></b>	<b><u>\$ 1,000</u></b>
<b>x 100% x ? days</b>			
<b>Potential market loss</b>	<b>\$ 2,060</b>	<b>\$ 1,290</b>	<b>\$ 790</b>
<b>For 100 MWh/day</b>	<b>\$ 206</b>	<b>\$ 129</b>	<b>\$ 79</b>
<b>For 10,000 MWh/day</b>	<b>\$ 20,600</b>	<b>\$ 12,900</b>	<b>\$ 7,900</b>
<b>Reduction in exposure</b>		<b>37%</b>	<b>62%</b>

(1) Collateral held for Mass Transition events increased with the implementation of PRR 568 given that collateral is maintained at 40 days and credit exposure for historical activity was reduced by 7 days with PRR 568.

# What is the *appropriate* exposure level?

- **Recognizing the Board of Directors is ultimately charged with developing rules and guidelines which are sufficient to ensure the ERCOT market is financially stable and that:**
  - The Credit Work Group recommended further credit tightening via PRR 683
  - The market provided its input indicating its desire to halt further credit tightening by rejecting PRR 683
- **To aid the BOD in its determination of next steps:**
  - ERCOT staff proposes seeking an independent review of ERCOT's Protocols related to credit within the context of ERCOT market operations
    - Benchmark ERCOT credit risk with other ISOs as well as against best practices
  - ERCOT staff continue to pursue catastrophic coverage via credit insurance
- **ERCOT requests BOD endorsement of proposed staff actions**

Note - PRR 683 - Reduce Timeline for Notice and Cure and Create a Working Credit Limit