Oliver Wyman – Credit Evaluation of Project Results

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Background – How did we get to today?

- **Market losses in 2003 and 2005/2006 -** $21 million
- **Market implemented additional mitigation following both events**
  - However, there was still loss exposure in the market
- **Faced with an ever changing risk landscape and unknown exposure**
  - Impact of changing credit quality of market participants

	Average Daily Load		Average Daily Generation	
By QSE				
Meets Creditworthiness Standards	234,174.50	22%	225,883.40	21%
Doesn't Meet Creditworithiness Standards				
Posts Guarantee (parent or 3rd party)	554,889.50	52%	253,214.90	24%
Posts Cash or LC	277,544.90	26%	587,510.60	55%
Total for August 2007	1,066,608.90		1,066,608.90	

Background – How did we get to today?

- What happens to exposure if the credit quality of MPs goes up or down?
  - How much more likely are market participants to default?
  - How much can “weak” market participants absorb before there are additional defaults?

- Impact of changing market rules
  - Move to an “energy only” market with a $3,000 price cap
  - Move to Nodal market with DAM and CRRs

- **At the March 2007 credit workshop, F&A, in its oversight role,**
  - discussed whether credit risk was adequately addressed, ***for the market as a whole***, 1) at that date and 2) whether sufficient tools were available to monitor potential credit exposure as risk factors change (to avoid surprises)
  - concluded that ERCOT should obtain an independent assessment of credit exposure
    - To provide a more comprehensive and objective way to measure and discuss credit exposure

Background – How did we get to today?

- **Oliver Wyman was ultimately selected for the project because they demonstrated the best blend of energy market and credit experience to do the project**

- **In July, 2007, the BOD authorized ERCOT to contract with OW to:**
  - Provide an independent assessment of ERCOT credit practices
  - Develop a model to more objectively measure the credit exposure
  - Provide a baseline assessment of credit risk in the market

- **At the time, ERCOT indicated to the BOD that we hoped to be able to provide data to make the following statements:**
  - At a specific point in time and for a specific timeframe, we are xx% confident that the market will not have losses in excess of $xx.
  - At a specific point in time and for a specific time frame, we are xx% confident that the market can withstand losses of $xx.

Background – How did we get to today?

- **The project has taken about 6 months**
  - ERCOT staff has been integrally involved in the process
  - CWG sponsored 2 workshops to discuss underlying assumptions and modeling techniques
    - Open sessions where TAC members and other MPs were invited to attend
    - Meetings attended by a broad cross-section of market segments
  - OW interviewed individuals across various market segments in the process of identifying key risk factors and concerns
  - CWG has reviewed the baseline assumptions and results
  - TAC has requested a separate briefing in connection with their March meeting

- **Oliver Wyman's participation is coming to an end with the presentation today, but the work will be ongoing**
  - As we look at additional scenarios of interest to the market and the BOD
  - As we update assumptions based on changes in MP credit quality and market risk factors

- **With this tool, we have the ability to discuss credit risk more objectively.**
  - Ability to analyze what is *likely* to happen and what CAN happen in more extreme situations

- **As desired by the BOD, this tool provides critical data necessary to aid the BOD to make decisions about acceptable levels of credit exposure in the market.**

ERCOT staff perspective

ERCOT staff

- **appreciates the BOD's leadership in this area**
- **believes it is very important for all stakeholders to have a clear understanding of credit exposure and whole-heartedly supports this exercise.**
- **believes the model provides a much greater ability to analyze key risk factors to gain an overall understanding of the credit exposure in the market as a whole.**
  - Historically, credit has been addressed only piecemeal and usually in a "reactive" mode
  - Prospectively we can be more proactive in warning market participants and other stakeholders of risks in the market

With that, I will turn this over to Bob Kopech, with Oliver Wyman, to walk the BOD through the results of the project.