



Commodity Exchange Act Exemption Status

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Finance & Audit Committee Meeting

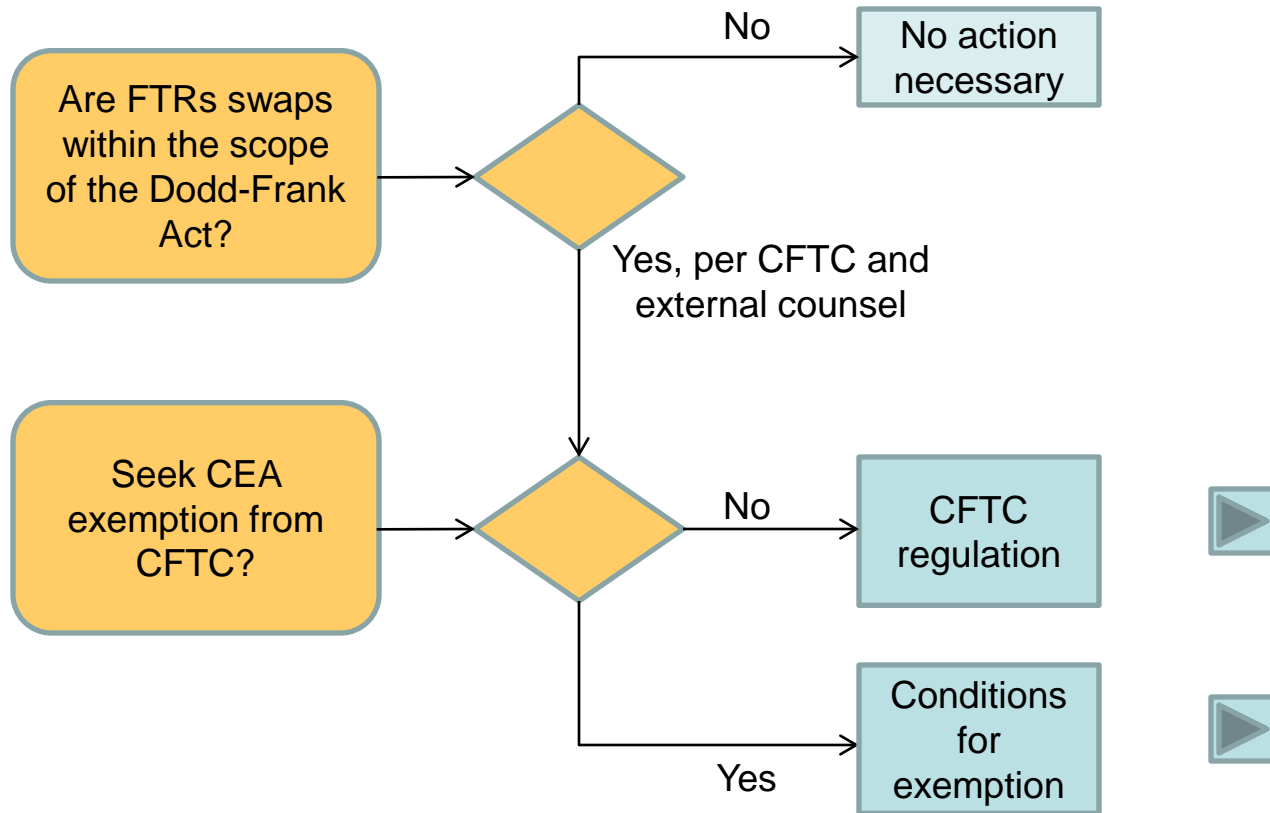
September 19th 2011

ERCOT Public

ERCOT is in the process of preparing an application for a Commodity Exchange Act exemption with the CFTC.

- ERCOT is continuing discussions with the CFTC with respect to the scope and terms of an exemption.
 - The filing date is not yet known.
- At this time ERCOT expects to continue to seek Central Counterparty (CCP) status, which is expected to provide setoff protections in bankruptcy.
- ERCOT staff has posted the portions of the draft CFTC exemption application that reference ERCOT standards and plans on the ERCOT website.

CEA Exemption Process Decision Tree





CFTC
regulation

Potential CFTC Compliance Requirements

- Register as a Swap Execution Facility and/or Derivatives Clearing Organization
- Maintain CFTC-determined position and accountability limits for covered transactions
- Daily, quarterly and annual CFTC reporting, including positions and margin amounts
- Monitoring of trading activity on a real-time basis to detect fraud or other regulatory violations
- Compliance with CFTC requirements including, but not limited to:
 - Fitness standards for Directors and Market Participants,
 - Composition of governing bodies,
 - Diversity within governing bodies,
 - Conflicts of interest,
 - Record-keeping and reporting, in some cases from Market Participants,
 - Credit and risk management provisions, and
 - Settlement procedures.



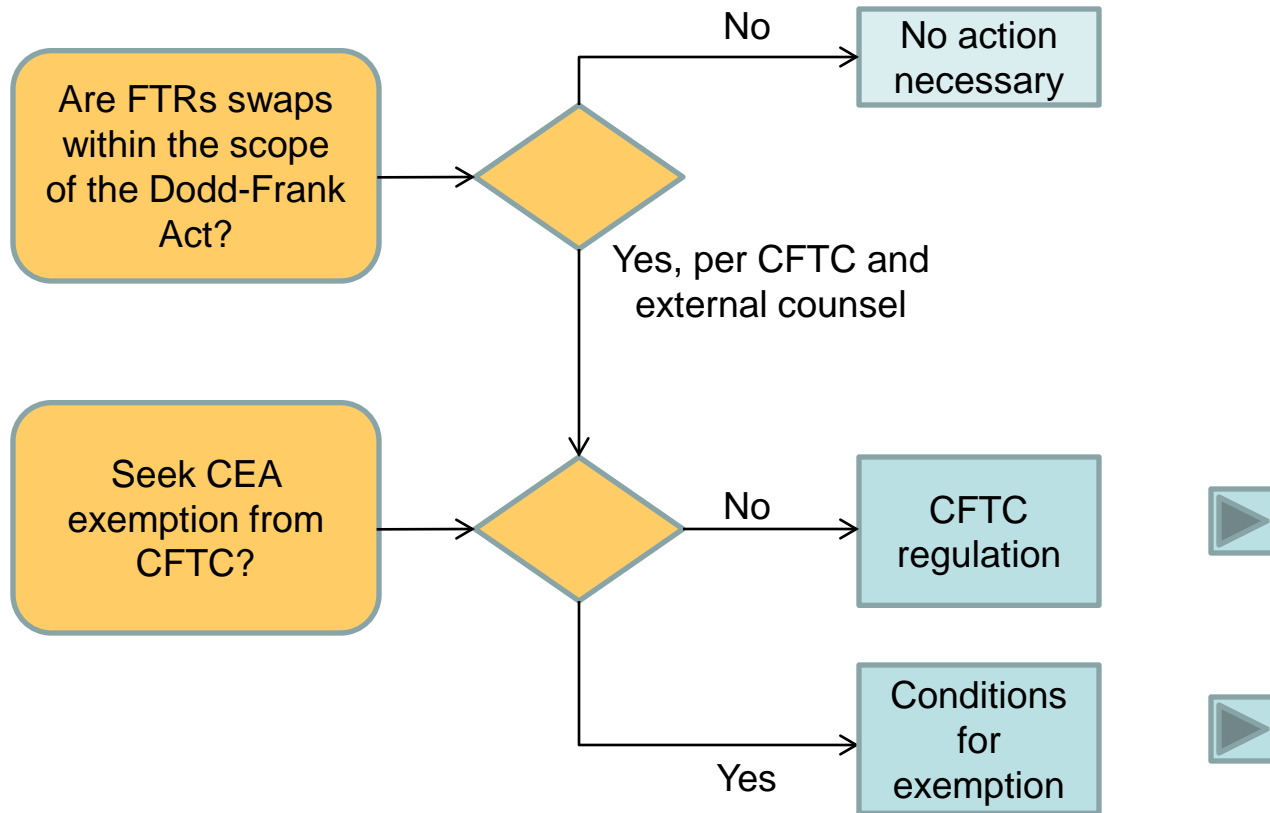
CFTC
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Potential CFTC Compliance Requirements

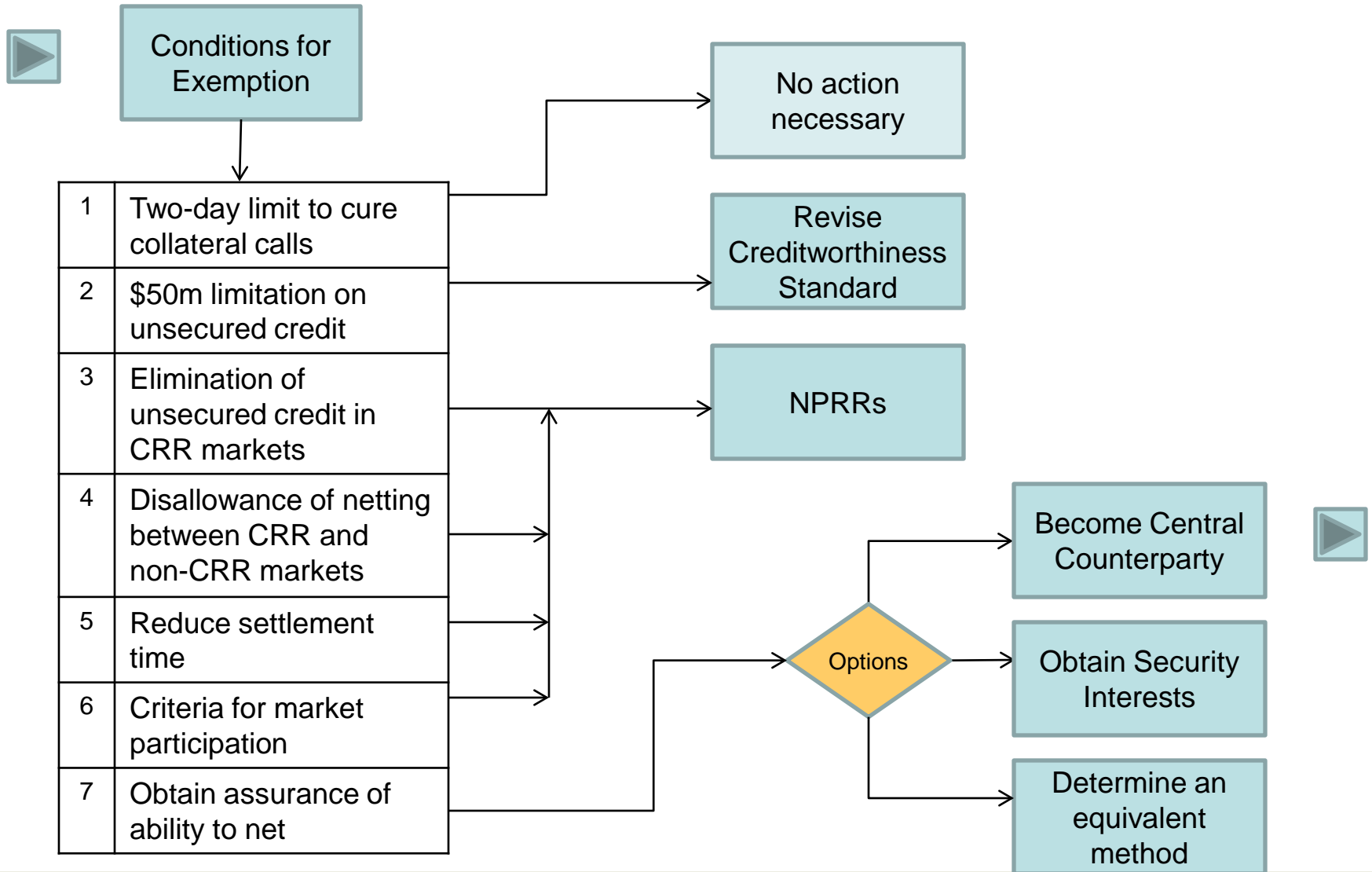
- Mandatory clearing and exchange trading for financial entities, in compliance with CFTC trade execution requirements (more rigorous than ERCOT's). Non-financial entities may opt out of mandatory clearing subject to final rule.
- Potential registration as a swap dealer for Participants in multiple markets (based on overall dealing activity)
- Potential CFTC penalties for CEA violations include:
 - Civil penalties \$140,000 per violation (\$1 million for manipulation), or triple the monetary gain to the violator,
 - Injunctions or cease and desist orders, and
 - Prohibitions on trading covered instruments (CRRs).

ERCOT staff believes that meeting and maintaining compliance with CFTC regulatory standards would require material changes to ERCOT Protocols, processes and systems.

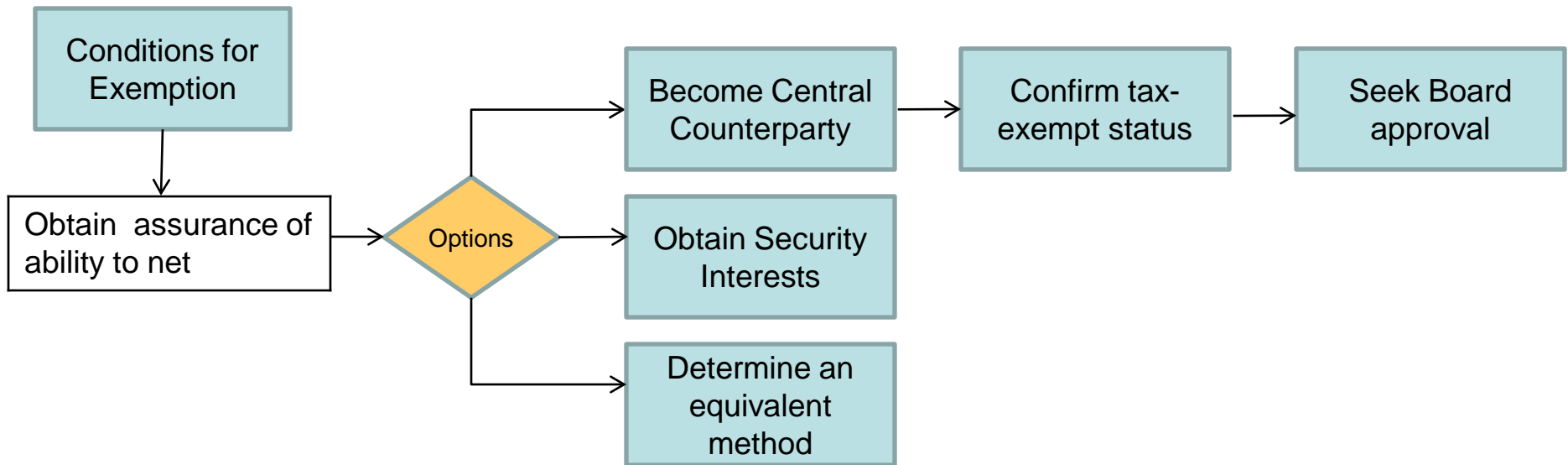
CEA Exemption Process Decision Tree



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- The rationale is to clarify the ISO/RTO's legal status in market transactions and therefore help ensure mutuality. This should provide support for the right to set-off offsetting positions in bankruptcy.
- The CCP approach was adopted independently by PJM (PJM Settlement Inc.) in January 2011. In addition to providing clarity as to mutuality, PJM also argued that the CCP structure provides value to market participants wishing to optimize credit positions across different PJM markets.

Central Counterparty

- It is ERCOT staff's understanding that all ISOs/RTOs except MISO will be adopting a central counterparty structure. MISO maintains that the resulting mutuality lacks substance and would not be upheld.
- ERCOT external counsel has indicated that, in their opinion, establishment of a CCP would be the cleanest way to ensure set-off across ERCOT markets (including Day Ahead and Real Time) in the event of bankruptcy.
- ERCOT staff does not believe that becoming a Central Counter-Party will significantly increase risk to ERCOT, Inc. given the protection in the Protocols that requires ERCOT to uplift losses to market participants in the event of a market participant default.
 - ERCOT staff believes that the language in the Protocols, along with revised contracts with Market Participants, will adequately address potential risks.

Implementation

- A CCP would not be implemented until
 - a) receipt of IRS confirmation that ERCOT would maintain tax exempt status and,
 - b) final authorization from the Board of Directors.
- ERCOT is considering legal options for establishing the CCP. It is ERCOT staff's current view that a separate legal entity would not meet ERCOT's immediate needs, and there is a risk it would entail greater costs and administrative complexity.
- ERCOT banks have been notified that ERCOT is contemplating becoming a CCP.
- It is anticipated that some revisions will be required to Protocols and to the Standard Form Market Participant Agreement.
- A subgroup of the CWG interested in exploring the use of a 3rd party as a CCP are looking into the potential benefit to market participants

Expected CFTC Conditions for CEA Exemption

	Item	Status
1.	Two-day limit to cure collateral calls	No action necessary.
2.	Elimination of unsecured credit in CRR market	NPRR 400 filed (September PRS review).
3.	Disallowance of netting between CRR and non-CRR markets	
4.	Reduce settlement timeline	<ul style="list-style-type: none"> NPRR 347 combines invoices for day-ahead and real time markets (approved by Board in August). NPRR 391 shortens settlement cycle by one day and eliminates Automated Clearing House (ACH) payments (September TAC vote).
5.	\$50m limitation on unsecured credit	Revision to Creditworthiness Standard approved by CWG on August 4 th . Expect to request Board action at October Board meeting.
6.	Criteria for market participation	Proposed standards for participant attestation, capitalization and risk management capability verification reviewed with CWG on August 4 th . NPRR to be drafted as scope finalized. Verification standards under joint review by ISOs/RTOs and by CCRO.
7.	Become a central counterparty (CCP)	Request for IRS letter ruling to confirm tax-exempt status of CCP is pending.

Questions