Item 4: Periodic Report on Credit Work Group Activity

Michael Mathews
Chair, Credit Work Group

Finance and Audit Committee Meeting
October 13, 2014
ERCOT Public

Credit Work Group (CWG) Update

NPRR 638

- Tabled at September CWG meeting to allow further consideration of whether MAX or Average is more appropriate in determining Real Time Net Energy Volumes
- Added language to require TAC and ERCOT Board approval for changes to the MAF (Market Adjustment Factor) (replaces SAF (Seasonal Adjustment Factor))
- Held special joint CWG/MCWG meeting on October 3rd
- Expected to pass at October 15th CWG meeting

Credit Work Group Update

NPRR 639

- Adjusts the MCE (Minimum Current Exposure) calculation to better align required collateral with risk by allowing a credit for net long bilateral positions counter parties with load
- The credit for net long bilateral positions is discounted by the Bilateral Trade Credit Factor (BTCF)
- CWG recommended BTCF=80% to mimic the similar discounting of the credit given for net generation

Credit Insurance

- ERCOT's insurance brokers requested per Name coverage amounts
- The CWG agreed that having to set coverage amounts for each name was unworkable/undesirable and so have abandoned the effort for the present

Credit Work Group Update

Alternative to Credit Insurance

- ERCOT arranges a credit facility to be used in the event of a default over some pre-established threshold
- The credit facility could be a letter of credit or some other form of short term financing
- Short-term financing rolled into longer term debt with payback period based on the size of the default
- Advantages
  - Mitigates the risk that a default could cause a cascade of defaults because short payments to market participants are capped at a pre-established level
  - Should be relatively inexpensive
- Disadvantages
  - Does not transfer risk so any market loss is actual, which is also the case today
  - Correct Allocation of debt repayment costs could be difficult

Credit Work Group Update

Capacity Forecast Model

- ERCOT presented a model relating 4-day ahead forecast of reserves to actual reserves with fairly good explanatory power R^2 =0.84 for whole year and R^2 =0.91 for the summer
- With the implementation of the operating reserve demand curve (ORDC), we expect an increased correlation between reserves and prices
- The idea is to create a methodology that will identify potential scarcity events during the forward week and adjust collateral requirements to reflect the increased risk
- This approach has the potential to adjust collateral requirements proactively to short-term market conditions