



Item 5: Periodic Report on Credit Work Group Activity

Donald Meek

Chair, Credit Work Group

Finance & Audit Committee Meeting

June 8, 2015

ERCOT Public

Credit Work Group Update – Reviewed NPRRs

NPRR 690: Incorporation of Creditworthiness Standards into Protocols

- Clarifies discrepancies between requirements for NOIE entities with/without credit ratings as well as eliminating F&A annual concentration limit reviews.
- Passed unanimously and CWG comments circulated April 22, 2015.

NPRR 680: Allow QSEs to Self-Arrange AS Quantities Greater than Their AS Obligation

- Provides additional flexibility for QSEs/LSEs to hedge their physical Ancillary Service Obligations. Current credit rules address this activity and adjustments are not needed.
- Passed unanimously as to credit impact and CWG comments circulated May 21, 2015.

Other NPRRs Reviewed by CWG

- NPRR 681 Clarifications to Dynamic Ratings
- NPRR 686 Changing the IRR Forecast from Next 48 Hours to Next 168 Hours
- NPRR 687 Required Telemetry for Operational Awareness and PDCWG Analysis
- NPRR 688 Black Start Services Testing Clarifications
- NPRR 684 Remove Annual RUC Impact Report Requirement
- NPRR 692 Removal of MIS Posting Requirement of DAM Credit Parameters
- NPRR 693 Incorporation of “Threshold Values for Competitive Constraint Test”
- NPRR 694 Non-Spin Schedule Requirements
- NPRR 695 Posting Requirements for Change of Generation Resource Designation
- NPRR 698 Clarifications to NPRR595, RRS Load Resource Treatment in ORDC
- NPRR 699 Energy Offer Curve Caps for Make-Whole Calculations, Fuel Type Other
- NPRR 700 Utilizing Actual Fuel Costs in Startup Offer Caps

Credit Work Group Update

NPRR 638: Revision to Price Components of EAL - Background

- NPRR638 revises the Real-Time Liability Extrapolated (RTLE) and Day-Ahead Liability Extrapolated (DALE) factors used in the calculation of Counter-Party Estimated Aggregate Liability (EAL) with an attempt to introduce seasonality.
- The NPRR replaces recent invoice prices used the current calculation with Settlement Point specific prices computed as the P84 of a price set including Interval prices looking back one week relative to the Operating Day, and forward three weeks relative to the operating day over the past three years.
- Filed in July 2014 and passed/endorsed at the January 2015 CWG Meeting.
- Subsequent to passing CWG, comments were filed by Reliant and Freeport LNG proposing new language related to the usage of historical Fuel Index Prices (FIP) and by ERCOT proposing that the MAF notice period be increased from 14 to 45 days and may be adjusted at the sole discretion of ERCOT due to market rule or market condition changes.
- Compromise language issues related to the FIP adjustment and MAF notice period were agreed to and endorsed by CWG at the April 2015 meeting providing TAC input for market rule changes with an expedited process with only Board/F&A approval in more urgent cases (with TAC notification).

Credit Work Group Update

NPRR 638: Revision to Price Components of EAL - Update

- **Significant concerns have been identified in the NPRR638 methodology by reviewing detailed modeling results provided by ERCOT staff**
 - CWG / CRIM met 3 times in May to analyze results and suggest changes
 - April 22 MCWG/CWG: Concerning model results identified
 - May 1 CRIM: In depth review of volatility & lookback period parameters
 - May 13 CRIM: Volume and pricing data analyzed separately
 - May 20 MCWG/CWG: Numerous issues identified without apparent solution
- **Summary of Issues:**
 - Strong seasonality not observed
 - Using historical prices to predict future prices will introduce some degree of anomaly; highly sensitive to Resource Node prices
 - Separating MW positions from pricing outcomes produces results that are not representative of actual Market Participant behavior or credit risk
 - Not limited to lookback, does not consider physical generation or other hedges particularly in shoulder months when generation is available but may not run
 - Excessive complexity and difficulty shadowing

Credit Work Group Update

NPRR 638: Revision to Price Components of EAL – Going Forward

- **CWG review of the intent of NPRR 638 with the stated business case of the NPRR being “proposed so that calculated credit exposures will reflect some degree of seasonality with a forward basis, thereby beginning to increase prior to summer months”**
 - General consensus by CWG that the intended seasonality was not evident in the model results provided by ERCOT staff
 - Similar consensus that the model results were not even necessarily a ‘better’ approach to credit posting requirements than what exists today
 - Given the sensitivity of the model to various parameters (lookback periods, P84 pricing percentile, etc.), any small parameter value change may result in significantly different credit requirements and can not easily be fixed
- **Decision by CWG to place NPRR 638 ‘on hold’ while alternatives explored**
 - Revisit intention of NPRR 638 – is seasonality (with summer month bias) the goal
 - Consider marking exposure based on forward ERCOT market price curves
 - Formula-based Seasonal Adjustment Factor
 - Discuss formula ‘tweaks’ to better attempt to tie prices and volumes
 - Consider adopting other portions of NPRR 638 not tied to forward looking pricing

Credit Work Group Update

Development of Market Risk Appetite Goal

- As requested by F&A, CWG has set a goal to assess various approaches to establishing an ERCOT Market Risk Appetite
- The goal covers both market risks associated with market participant activities in both 'normal' markets as well as during 'extreme events' where tail risk pricing may exceed market participant posted collateral levels
- CWG work on developing a Market Risk Appetite Goal was temporarily deemphasized during extensive discussions and data analysis on NPRR 638
- High priority topic after resolution of NPRR 638 is addressed

Reelection of CWG Vice-Chair due to Market Segment Change

- The CWG Vice-Chair, Loretto Martin resigned from LCRA and is now employed by Direct Energy where she has assuming CWG membership
- A change in market segment membership resulted in a vacancy in the Vice-Chair position which was filled with the nomination and reelection of Loretto Martin at the April 2015 CWG meeting for the remainder of the 2015 term

Credit Work Group Update

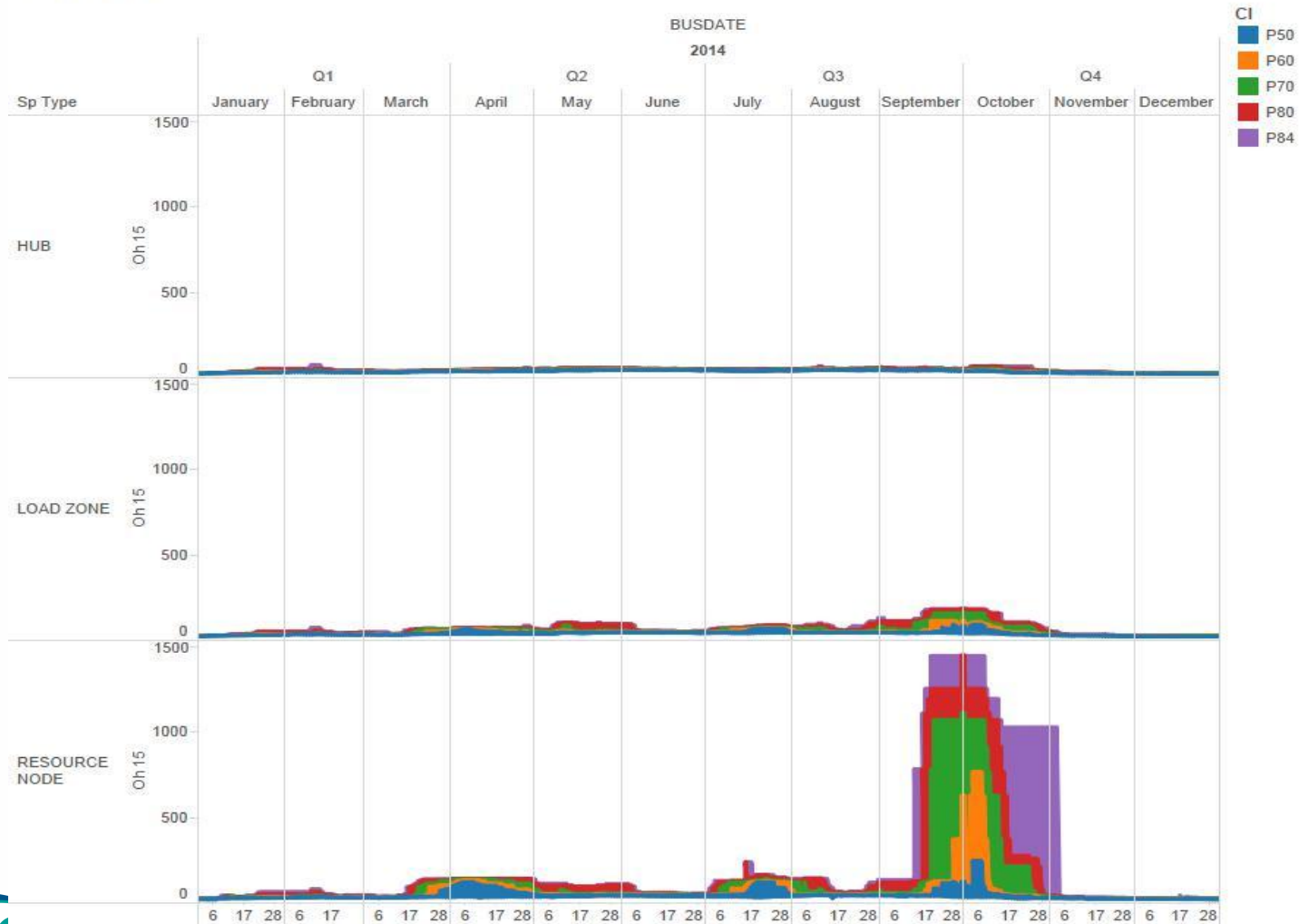
Other ERCOT Credit Related Activities

- **NPRR 484 – Revisions to Congestion Revenue Rights Credit Calculations and Payments (Phase II)**
 - Discuss various mechanisms for prepayment of deferred auction invoices including ERCOT proposals to split Long Term Auction Sequence (LTAS) by operating month and provide individual, prepayable invoices
- **NPRR 702 – Flexible Accounts, Payment of Invoices, and Deposit of Interest on Cash Collateral**
 - Approach to pay/receive invoices in a timely manner and reduce wire fees through use of a separate account from the cash collateral account.
 - Changes proposed involve paying invoices on the actual due date and a requirement to fund by noon for same-day automatic availability
- **Draft NPRR - Credit Protocols Clarifications and Corrections**
 - ERCOT has identified approximately 20 ‘clean up’ items and is preparing an NPRR to correct technical / clerical issues with current language
- **Credit Implications/Uses of ERCOT Developed Capacity Forecast Model**
 - Ongoing data being collected, further review after NPRR 638 addressed

Questions

Appendix: Credit Work Group Update on NPRR638

NPRR 638 RTSPP estimates with 1 year lookback using 2014 data at various confidence intervals



Appendix: Credit Work Group Update on NPRR638

Comparison of RTLE+DALE based on Current Protocols and NPRR638 with 3 years price lookback at 14 days of averaging RTM and DAM volumes (parameters *er* and *ed*)

A14 indicates 14 days of averaging *er*=14 and *ed*=14

