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| NPRR Number | [1205](https://www.ercot.com/mktrules/issues/NPRR1205) | NPRR Title | Revisions to Credit Qualification Requirements of Banks and Insurance Companies |
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| Date | | January 16, 2024 | |
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| Submitter’s Information | | | |
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| Market Segment | | Independent Generator | |

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| Comments |

Luminant appreciates the ability to submit comments on Nodal Protocol Revision Request (NPRR) 1205. Being both one of the largest posters of collateral to ERCOT and an Entity that faces some of the largest default uplift risk, Luminant is acutely aware of the balance that credit policies must strike between efficient cost and adequate risk coverage.

Luminant recognizes the value in many of the clarifications made in NPRR1205 and supports most of them; however, Luminant submits that NPRR1205’s proposed change to the minimum credit rating criteria to require that *all* credit rating agencies provide a rating of A-/A3 could be inefficiently restrictive on the supply of credit when taken in combination with other risk mitigation controls in the Protocols. To better coordinate these policy priorities, Luminant proposes to increase the maximum letter of credit issuer limits as a percentage of the issuer’s Tangible Net Worth. This should have the effect of reducing credit risk through higher credit rating criteria while offsetting the reduction of credit supply to market participants that comes from raising the credit rating bar. Concentration risk is limited, however, by retaining the $750 million per issuer maximum.

As demonstrated in the chart presented by ERCOT at the June 21, 2023 Credit & Finance Sub-Group (CFSG) meeting, ERCOT and ISO-NE have stood out vs. other Independent System Operators (ISOs) by making the marginal trade-off between allowing a collateral-supplying institution’s *best* credit rating to determine eligibility while capping the concentration of risk that a single institution can present to the market. Other ISOs instead have chosen to set a stricter credit rating threshold while having no caps on the amount of collateral that a single institution can provide.

NPRR1205 as filed would put ERCOT in a novel position amongst ISOs by *both* setting a higher credit rating threshold *and* retaining the limits on total collateral that a single financial institution can provide. Luminant recommends that ERCOT retain a balanced approach to this trade-off, and these comments propose to do that by doubling the percentage of net worth limits on total collateral provided via letter of credit by a single financial institution. This change would align ERCOT’s coordination of these two policy levers in a way that is more conservative than other ISOs, but co-optimizing quantity and quality to yield a lower cost for the credit risk reduction.

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| Revised Cover Page Language |

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| Business Case | In light of the recent takeover of Credit Suisse by UBS with the involvement of the Swiss government and Swiss central bank, potential regional banking crisis in the U.S., and overall concerns about credit tightening, ERCOT credit staff reviewed ERCOT’s current practices as it relates to qualifications for banks and insurance companies, which issue collateral instruments to ERCOT such as letters of credit and surety bonds on behalf of Market Participants. ERCOT staff also compared ERCOT’s current practices against the same at other Regional Transmission Operators / Independent System Operators.  This review identified several areas, which need to be corrected and/or clarified, including the following:   1. Current Protocols allow ERCOT to accept a letter of credit issuing bank as long as it is rated “A-“ (S&P equivalent) or above by at least one of the rating agencies, even if the issuing bank is rated in BBB range by one or two other rating agencies. This NPPR will require an issuing bank to have A- or above ratings across all rating agencies, if available. This change is balanced by doubling the percentage of Tangible Net Worth limits for letters of credit from a single issuer; 2. If there is a split rating amongst the agencies, ERCOT takes the average for capacity purposes. The subject NPRR will codify using the lowest of the ratings within the same rating agency and amongst rating agencies; 3. Rating is internally interpreted as “Long term rating, issuer rating, or long term bank deposit rating (domestic).” The proposal will define ratings as Long term issuer rating, Long term Senior Unsecured rating and Long Term Counterparty Risk Assessment (for Moody’s); 4. ERCOT does not require a U.S. branch of a foreign bank to be rated on its own. The proposal will require US branches of foreign banks to have their own standalone rating; 5. There are no minimum size qualifications for the surety bond/insurance companies in the Protocols. The proposal will require insurance companies to have a minimum Financial Size Category by AM Best of XII; and 6. Protocol language requires clarification to overall limit of $100 million per surety bond insurer for all ERCOT Counter-Parties to make clear that this cap applies to aggregate amounts of bonds issued by the companies belonging to the same corporate family.   This NPRR will strengthen credit qualification requirements of banks and insurance companies, whose collateral instruments ERCOT relies on to protect from credit risk posed by the Market Participants. |

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| Revised Proposed Protocol Language |

***16.11.3 Alternative Means of Satisfying ERCOT Creditworthiness Requirements***

(1) A Counter-Party required to provide Financial Security under these Protocols may do so through one or more of the following means:

(a) The Counter-Party may give an unconditional, irrevocable letter of credit naming ERCOT as the beneficiary. ERCOT may, in its sole discretion, reject the letter of credit if the issuer is unacceptable to ERCOT or if the conditions under which ERCOT may draw against the letter of credit are unacceptable to ERCOT.

1. The letter of credit must be given using the ERCOT Board-approved standard letter of credit form.
2. All letters of credit must be drawn on a U.S. domestic bank or a U.S. domestic office of a foreign bank.
3. (iii) Letters of credit must be issued by a bank or other financial institution that is acceptable to ERCOT, with a minimum rating of A- with S&P and Fitch and A3 with Moody’s. No letters of credit will be accepted from banks which are rated below A-/A3 by one or more rating agencies. If there are split ratings amongst rating agencies, ERCOT will use the lowest of different ratings within the same rating agency and amongst different rating agencies. The ratings are defined as follows (if available): Long term issuer rating, Long term Senior Unsecured rating or Long Term Counterparty Risk Assessment (for Moody’s). For U.S. offices of foreign banks, U.S. branch/office must have an acceptable rating on its own by at least one of the rating agencies.

(iv) Letters of credit are subject to an overall limit per letter of credit issuer for all ERCOT Counter-Parties as determined below:

| If the issuing entity has | | Then |
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| Long-Term or Issuer Rating | | Maximum letter of credit issuer limit as a percentage of Tangible Net Worth of issuer |
| S&P or Fitch | Moody’s |
| AAA | Aaa | 2.00% |
| AA+ | Aa1 | 1.90% |
| AA | Aa2 | 1.80% |
| AA- | Aa3 | 1.70% |
| A+ | A1 | 1.60% |
| A | A2 | 1.50% |
| A- | A3 | 1.40% |
| Below A- | Below A3 | Not accepted |

(A) Each letter of credit issuer limit is also subject to an overall limit of $750 million per issuer.

(B) Each Bank Business Day, ERCOT will issue a report of each letter of credit issuer detailing the issuer’s dollar amount of the letters of credit currently issued to ERCOT, the issuer’s computed aggregate concentration limit, and the unused capacity under that limit. Market Participants may inquire of ERCOT about intra-day changes to the amount of posted letters of credit.

(C) If a letter of credit issuer limit is breached, Counter-Parties utilizing that issuer will be notified and no new letters of credit from the issuer will be accepted while the limit remains breached.

(D) After four months of the limit in breach, ERCOT will no longer accept new letters of credit or amendments to existing letters of credit from that issuer.

(E) Letters of credit held as collateral at the time of an issuer limit breach will not be rejected.

(F) ERCOT in its sole discretion may authorize exceptions to these limits.

(G) Revisions to the issuer limit calculation in this Section will be recommended by the Technical Advisory Committee (TAC) and approved by the ERCOT Board. ERCOT shall update parameter values on the first day of the month following ERCOT Board approval unless otherwise directed by the ERCOT Board. ERCOT shall provide a Market Notice prior to implementation of a revised parameter value.

(b) The Counter-Party may give a surety bond naming ERCOT as the beneficiary.

(i) The surety bond must be signed by a surety acceptable to ERCOT, in its sole discretion and must be in the form of ERCOT’s standard surety bond form approved by the ERCOT Board. No modifications to the form are permitted.

(ii) The surety bond must be issued by an insurance company with a minimum rating of A- with S&P and Fitch and A3 with Moody’s, if available. No surety bonds will be accepted from insurance companies, which are rated below A-/A3 by one or more rating agencies. If there are split ratings amongst rating agencies, ERCOT will use the lowest of different ratings within the same rating agency and amongst different rating agencies.

(iii) Surety bonds are subject to a limit of $10 million per Counter-Party per insurer and an overall limit of $100 million per insurer for all ERCOT Counter-Parties. This overall limit is aggregated for the entire corporate family in case of multiple insurance companies belonging to the same corporate family.

(iv) The surety bond must be issued by an insurance company with a minimum financial size category of XII as determined by AM Best.

(c) The Counter-Party may deposit Cash Collateral with ERCOT with the understanding that ERCOT may draw part or all of the deposited cash to satisfy any overdue payments owed by the Counter-Party to ERCOT. The Cash Collateral may bear interest payable directly to the Counter-Party, but any such arrangements may not restrict ERCOT’s immediate access to the cash.

(i) Interest on Cash Collateral will be calculated based on Counter-Party average Cash Collateral balances. Interest is not paid on Cash Collateral balances held by ERCOT where, in accordance with paragraph (4) of Section 16.11.7, Release of Market Participant’s Financial Security Requirement, the Counter-Party’s Standard Form Market Participant Agreement has been terminated and ERCOT has determined that no obligations remain owing or will become due and payable.

(ii) Once per year, ERCOT will:

(A) Return interest earned on a Counter-Party’s Cash Collateral to the Counter-Party if the amount of interest earned is greater than $50; or

(B) Retain interest earned on a Counter-Party’s Cash Collateral as additional Cash Collateral if the amount of interest earned is less than or equal to $50.

(iii) ERCOT has a security interest in all property delivered by the Counter-Party to ERCOT from time to time to meet the creditworthiness requirements, and that property secures all amounts owed by the Counter-Party to ERCOT.