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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 |
| Date of Decision | | March 20, 2024 | |
| Action | | Recommended Approval | |
| Timeline | | Normal | |
| Estimated Impacts | | Cost/Budgetary: Between $80K and $120K  Project Duration: 5 to 8 months | |
| Proposed Effective Date | | Upon system implementation | |
| Priority and Rank Assigned | | Priority – 2025; Rank – 4520 | |
| Nodal Protocol Sections Requiring Revision | | 16.11.3, Alternative Means of Satisfying ERCOT Creditworthiness Requirements | |
| Related Documents Requiring Revision/Related Revision Requests | | Surety Bond Form | |
| Revision Description | | This Nodal Protocol Revision Request (NPRR) strengthens ERCOT’s market entry eligibility and continued participation requirements for ERCOT Counter-Parties (i.e., Qualified Scheduling Entities (QSEs) and Congestion Revenue Right (CRR) Account Holders). Specific changes include strengthening and clarifying minimum credit quality qualifications for:   * Banks, which issue letters of credit on behalf of Market Participants to ERCOT; and * Insurance companies, which issue surety bonds on behalf of Market Participants to ERCOT. | |
| Reason for Revision | | [Strategic Plan](https://www.ercot.com/files/docs/2023/08/25/ERCOT-Strategic-Plan-2024-2028.pdf) Objective 1 – Be an industry leader for grid reliability and resilience  [Strategic Plan](https://www.ercot.com/files/docs/2023/08/25/ERCOT-Strategic-Plan-2024-2028.pdf) Objective 2 - Enhance the ERCOT region’s economic competitiveness with respect to trends in wholesale power rates and retail electricity prices to consumers  [Strategic Plan](https://www.ercot.com/files/docs/2023/08/25/ERCOT-Strategic-Plan-2024-2028.pdf) Objective 3 - Advance ERCOT, Inc. as an independent leading industry expert and an employer of choice by fostering innovation, investing in our people, and emphasizing the importance of our mission  General system and/or process improvement(s)  Regulatory requirements  ERCOT Board/PUCT Directive  *(please select ONLY ONE – if more than one apply, please select the ONE that is most relevant)* | |
| Justification of Reason for Revision and Market Impacts | | 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. | |
| PRS Decision | | On 11/9/23, PRS voted unanimously to table NPRR1205 and refer the issue to the Credit Finance Sub Group (CFSG). All Market Segments participated in the vote.  On 2/8/24, PRS voted unanimously to recommend approval of NPRR1205 as amended by the 1/16/24 Luminant comments. All Market Segments participated in the vote.  On 3/20/24, PRS voted unanimously to endorse and forward to TAC the 2/8/24 PRS Report and 10/24/23 Impact Analysis for NPRR1205 with a recommended priority of 2025 and rank of 4520. All Market Segments participated in the vote. | |
| Summary of PRS Discussion | | On 11/9/23, participants requested tabling for additional review at CFSG.  On 2/8/24, participants noted the CFSG endorsement of the 1/16/24 Luminant comments.  On 3/20/24, participants reviewed the 10/24/23 Impact Analysis for NPRR1205 and discussed the appropriate priority and rank. | |

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| **Opinions** | |
| Credit Review | See 2/23/24 CFSG comments |
| Independent Market Monitor Opinion | To be determined |
| ERCOT Opinion | To be determined |
| ERCOT Market Impact Statement | To be determined |

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| Market Segment | Not applicable |

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| **Comments Received** | |
| Comment Author | **Comment Summary** |
| Luminant 011624 | Proposed edits doubling the percentage of Tangible Net Worth limits for letters of credit from a single issuer |
| CFSG 011924 | Endorsed NPRR1205 as amended by the 1/16/24 Luminant comments |
| CFSG 022324 | Noted NPRR1205 provides positive credit impacts by strengthening credit qualification requirements of banks and insurance companies |

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| **Market Rules Notes** |

Please note the baseline Protocol language in Section 16.11.3 has been updated to reflect the incorporation of the following NPRR(s):

* NPRR1184, Update to Procedures for Managing Interest on Cash Collateral (partially unboxed 2/26/24)

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| Proposed Protocol Language Revision |

***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.

(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 shall be invested pursuant to the ERCOT Investment Corporate Standard and all interest received on Cash Collateral will be payable directly to the Counter-Party; provided, however, that any such arrangements may not restrict ERCOT’s immediate access to the cash.

(i) Interest on Cash Collateral will be calculated on a monthly basis, based on average daily balances of the Counter-Party Cash Collateral. 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) On or before the 15th Bank Business Day of each month, ERCOT will credit each Counter-Party’s Cash Collateral account for the amount of interest calculated for Cash Collateral held by ERCOT for the prior month.

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| ***[NPRR1184: Insert paragraph (iii) below upon system implementation and renumber accordingly:]***  (iii) In addition, ERCOT will provide a report containing details on how the interest amount was calculated for that month, which shall include, at a minimum, the daily principal amount of the Cash Collateral held from the Counter-Party and the imputed yield. |

(iii) ERCOT has a first priority 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.