Enhancements to NYISO Creditworthiness Policies:

Revisions to Credit Scoring Methodology

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July 29, 2009

Background: Why modify credit policies?

- A Market Participant's creditworthiness can deteriorate quickly and severely, especially during times of financial uncertainty such as current unprecedented economic conditions
- Heightened concern regarding potential Market Participant defaults exists because of:
  - Diminished liquidity in capital markets
  - Increased borrowing costs
  - Challenges meeting pension funding requirements
  - Decreased overall profitability/liquidity
  - Potential increase in end-user defaults
  - Delayed issuance of earnings guidance adds additional difficulty in assessing the financial health of Market Participants
- NYISO has experienced "near misses", including Lehman Brothers and others, within the last year that easily could have resulted in significant socialized bad debt losses (NYISO and its Market Participants are fortunate to have avoided bad debt losses in recent economic conditions)
- NYISO's liquidity reserves (working capital and bank revolving credit facility) may not be sufficient to address the magnitude of potential defaults
- While other ISOs have revamped their credit policies following defaults, NYISO has developed a series of policy enhancement recommendations on a proactive, strategic basis.

Background: Schedule

- NYISO, in conjunction with credit/risk management consultants, developed a revised credit scoring methodology for Market Participant consideration. This enhancement has been discussed to date at the following Market Participant meetings:

  11/21/08 CPTF
  1/16/09 CPTF/BPCTF
  1/28/09 CPTF
  2/17/09 CPTF/BPCTF
  3/20/09 MIWG
  3/27/09 CPTF
  4/01/09 MIWG
  4/20/09 CPTF
  5/01/09 CPTF
  5/12/09 MIWG
  6/01/09 MIWG
  6/10/09 BIC
  6/24/09 MC

Background: Schedule

- NYISO plans to utilize the following schedule for this credit policy enhancement:
  - *MC:* *July 29*
  - *BOD:* *August 18*
  - *FERC Filing (see note below):* *August*
  - *Implementation:* *Upon FERC approval*

- Note: NYISO's creditworthiness requirements are currently included in Attachment W of the OATT and Attachment K of the MST. In the FERC filing to request approval of these enhancements, NYISO plans to amend Attachment K of the MST and to replace Attachment W of the OATT with a cross-reference to Attachment K of the MST. This avoids maintaining duplicate tariff sections and minimizes NYISO edits and Market Participant reviews, etc.

Enhancement 9 – Credit Scoring Changes

- Current Policy
  - A Market Participant with an investment grade rating may qualify for unsecured credit in an amount equal to a percentage of its tangible net worth. This amount is the "starting point" for determining the amount of unsecured credit granted to a Market Participant.
  - The NYISO may adjust a Market Participant's starting point upward or downward based upon a credit assessment of the Market Participant compared to industry peers. The starting point is also subject to the NYISO concentration cap.
  - The credit assessment methodology requires the NYISO to evaluate the following factors (weighted as indicated):

• Liquidity	55%
• Leverage and debt coverage	15%
• Performance and profitability	15%
• Qualitative Assessment	15%

Enhancement 9 – Credit Scoring Changes

ISO/RTO	Unsecured Credit Methodology (amounts subject to cap)	Basis for Reduction in Amount of Unsecured Credit
CAISO	Rated Entity[1]: 0 - 7.5% of TNW based on Agency Rating and Moody's KMV Equivalent Rating [1]Rated Governmental Entity: 0 - 7.5% of Net Assets based on Agency Rating Unrated Entity[2]: 0 - 7.5% of TNW based on Moody's KMV Equivalent Rating [2]Unrated Governmental Entity: 0 - 7.5% of Net Assets based on financial metrics, or amount equal to amount appropriated by govt. Locally Owned Public Utilities: $1M credit limit without regard to Net Assets	Decrease in TNW Downgrade in Agency Rating Decrease in Moody's KMV Rating Deterioration in Financial Performance CAISO has right to adjust unsecured credit downward by up to 100%, in its sole discretion, based on its assessment of qualitative factors, quantitative credit strength indicators, and other factors
ISO-NE	Rated Entity: 0 - 5.5% of TNW based on Agency Rating Unrated Entity: 0.5% of TNW so long as -- Current Ratio > = 1.0 -- Debt-to-Total Cap Ratio < = 0.6 -- EBITDA-to-Interest Exp Ratio > = 2.0 -- ISO-NE may adjust thresholds, in its sole discretion, for municipal MPs	Decrease in TNW Downgrade in Agency Rating Deterioration in Financial Performance ISO-NE may require collateral if there is a material change in the financial condition of a market participant

Enhancement 9 – Credit Scoring Changes

ISO/RTO	Unsecured Credit Methodology (amounts subject to cap)	Basis for Reduction in Amount of Unsecured Credit
MISO	Credit assessment results in Composite Score Composite Score determines % of TNW Non-Public Power Sector: 0 - 10% of TNW based on Composite Score; credit assessment is 60% quantitative and 40% qualitative Public Power Sector: 0 - 12% of TNW based on Composite Score; credit assessment is 40% quantitative and 60% qualitative	Decrease in TNW Downgrade in Agency Rating Deterioration in Financial Performance Worsening Qualitative Factors
PJM	Rated Entity: 0 - 7.5% of TNW based on Credit Score based on Agency Rating and Credit Watch status Unrated Entity: 0 - 7.5% of TNW based on Credit Score; PJM determines Credit Score based on "PJM's review and analysis of various factors that are predictors of financial strength and creditworthiness" PJM will consider other alternative measures for determining the financial strength of municipalities	Decrease in TNW Downgrade in Agency Rating Deterioration in Financial Performance Worsening Qualitative Factors (Unrated Entities) Material Adverse Change PJM has the right to modify any Unsecured Credit Allowance and/or require additional Financial Security as may be deemed reasonably necessary to support current market activity

Draft – For Discussion Only

Enhancement 9 – Credit Scoring Changes

- Proposed Enhancement
  - Revise the credit assessment methodology as follows:
    - Evaluate, where possible, leading indicators of financial performance instead of lagging indicators.
    - Eliminate peer comparison.
    - Adjust the actual amount of unsecured credit granted to a Market Participant, as opposed to its starting point amount, upward (to a maximum of the NYISO concentration cap), or downward based upon the revised credit assessment methodology.
    - Utilize separate credit assessment methodologies for public and private Market Participants – see details on next slide.

Enhancement 9 – Credit Scoring Changes

- Proposed Enhancement (continued):

Public vs. Private categorization of Market Participants for use in Credit Scoring *

	Primary Criteria	Secondary Criteria	Scorecard Category	Data Source
1	Standalone public trading company	N/A	Public	MP's financials and market indicators
2	Subsidiary of a public company with its parent company as the guarantor	N/A	Public	Parent company's financials and market indicators
3	Subsidiary of a public company	With assets greater than $10B (measured in USD)	Public	MP's financials with parent company's market indicators
4	Subsidiary of a public company	Contributes 50% or more of its parent company's revenues or accounts for 50% or more of its assets	Public	MP's financials with parent company's market indicators
5	Subsidiary of a public company	Contributes less than 50% of its parent company's revenues or represents <50% of its assets	Private	MP's financials
6	Does not satisfy the criteria listed above		Private	MP's financials

** Note: Municipalities relying upon unsecured credit using the TNW methodology would be considered Private for credit scoring purposes. Municipalities relying upon unsecured credit using the $1M allowance only or the native load requirements only would not be evaluated using the credit scoring methodology. There are expected to be a limited number of municipalities using the native load requirements approach, and such entities will be required to provide NYISO with data relative to their financial performance. NYISO would continue to evaluate such entities for material adverse changes.*

Enhancement 9 – Credit Scoring Changes

- Proposed Enhancement – Public Entities. Revise credit assessment methodology to account for leading indicators of credit risk as follows:

	Proposed Weight
Market Indicators	
• Absolute CDS Spread	21.3%
• Relative Stock Decline from 3 month high	4.3%
• Stock Return Volatility (3 mth std deviation)	12.7%
Performance	
• Revenue/Market Cap	12.7%
• Retained Earnings/Assets	8.5%
Debt Coverage	
• Total Debt/EBITDA	12.7%
Leverage	
• Debt/(Total Debt + Equity)	8.5%
Liquidity	
• Cash/Assets	4.3%
Qualitative Assessment	15.0%

(Qualitative Assessment includes, but is not limited to, in the following priority order: ratemaking ability and legal right to fully recover end-user costs, industry characteristics, risk policies and procedures, management quality, ability to access funding in difficult market conditions, historical relationship with NYISO – i.e., margin call and payment history, liquidity/performance, etc. Transmission Owners, who can recover end-user costs pursuant to authority by the New York State Public Service Commission, would receive a Qualitative Assessment score no worse than 5 out of 10.)

Note: If one or more of the factors included in the credit scoring methodology does not exist, the weights of those factors would be reallocated proportionately or entirely reallocated to the Qualitative Assessment at the discretion of the NYISO.

Enhancement 9 – Credit Scoring Changes

- Proposed Enhancement – Private Entities. Revise credit assessment methodology to account for leading indicators of credit risk as follows:

	Proposed Weight
Performance	
• Return on Assets	17.5%
• Profit Margin	10.5%
Debt Coverage	
• Total Debt/EBITDA	17.5%
Leverage	
• Total Debt/Total Assets	17.5%
Liquidity	
• Cash/Assets	7.0%
Qualitative Assessment	30.0%

(Qualitative Assessment includes, but is not limited to, in the following priority order: parent/affiliate financial & market indicators (if applicable), ratemaking ability and legal right to fully recover end-user costs, industry characteristics, risk policies and procedures, management quality, ability to access funding in difficult market conditions, historical relationship with NYISO – i.e. margin call and payment history, liquidity/performance, etc. Transmission Owners, who can recover end-user costs pursuant to authority by the New York State Public Service Commission, would receive a Qualitative Assessment score no worse than 5 out of 10.)

Note: If one or more of the factors included in the credit scoring methodology does not exist, the weights of those factors would be reallocated proportionately or entirely reallocated to the Qualitative Assessment at the discretion of the NYISO.

Enhancement 9 – Credit Scoring Changes

- Proposed Enhancement (continued):
  Following a period of significant analysis regarding the credit scoring methodology and sensitivity analyses performed on alternate approaches, Oliver Wyman recommended adjustments to unsecured credit utilizing the tables below.

Initial Adjustment:

Will be made to actual unsecured credit derived from TNW credit matrix analysis

Score bucket	Public Score range	Private Score Range	Unsecured Credit Adjustment
1	0.00 – 0.33	0.00 – 0.31	0%
2	0.34 – 0.40	0.32 – 0.39	-20%
3	0.41 – 0.45	0.40 – 0.43	-50%
4	0.46 – 0.50	0.44 – 0.48	-80%
5	0.51+	0.49+	-100%

Transition Adjustment:

May update the scorecard score at any point, resulting in a further adjustment to credit

		Current score bucket				
		1	**2**	**3**	**4**	**5**
Previous score bucket	**1**	0%	-20%	-50%	-80%	-100%
	2	25%	0%	-38%	-75%	-100%
	3	100%	60%	0%	-60%	-100%
	4	400%	300%	150%	0%	-100%
	5	NA	NA	NA	NA	NA

- A Market Participant which is subject to a 100% reduction of credit will *not* be immediately eligible for a restoration of unsecured credit upon improving its credit score.
- To qualify for a restoration of unsecured credit, a Market Participant must demonstrate two quarters of credit-qualifying performance (i.e. initial adjustment of >-100%)

Enhancement 9 – Credit Scoring Changes

- Implementation Timeframe
  - Upon FERC Approval

- Rationale
  - The current credit scoring methodology (along with the initial determination of unsecured credit) is based exclusively on severely lagging indicators – ratings and financial statements
  - The current credit scoring methodology does not consider real-time events and financial conditions, which is particularly problematic when a Market Participant is experiencing rapid deterioration in financial health
  - The current credit scoring methodology is based on annual financial statements, which can include data from well over 1+ year(s) ago
  - Peer data is not necessarily relevant and/or comparable (e.g., companies may have different reporting timelines)
  - The current credit scoring methodology does not consider the concentration cap limitations when making adjustments.
  - When applied to Lehman during summer 2008, current methodology did not result in a reduced unsecured credit allocation whereas the proposed methodology would have reduced and ultimately eliminated Lehman's unsecured credit.

Enhancement 9 – Credit Scoring Changes

- Implications:
  When comparing the proposed policy enhancement to the current tariff methodology, the following points should be made with respect to Public Entities:
  - Approximately the same number of Market Participants would fall within the first tier of adjustments and have their unsecured credit adjusted by roughly the same amount (20% vs 25%)
  - Under the current methodology, no entity would have had their unsecured credit removed, whereas the proposed methodology does in fact remove or make significant adjustments to entities who are experiencing signs of significant financial distress.
  - For all Transmission Owners, it should be noted that the proposed methodology has resulted in either a comparable or better credit scoring assessment than the current tariff methodology (based on evaluations performed during February, April and July 2009).

Adjustments to Unsecured Credit per Current Tariff	Number of Entities affected under Current Tariff		% Adjustment – Initial Proposal	Number of Entities affected as of Feb. 2009	Number of Entities affected as of April 2009
0%	26		0%	10	15
25%	7		20%	11	6
50%	NA		50%	7	7
75%	0		80%	2	3
100%	0		100%	3	2

Enhancement 9 – Credit Scoring Changes

- Implications:
  Number of private entities (exclusive of municipalities and governmental agencies) by bucket using the initial Oliver Wyman proposal (qualitative assessment neutral)

  - For all Transmission Owners, it should be noted that the proposed methodology has resulted in either a comparable or better credit scoring assessment than the current tariff methodology (based on evaluations performed during February, April and July 2009).

Score Bucket	Score Range	Number of Entities Affected – as of 2/09	Unsecured Credit Adjustment
1	0.00 – 0.31	9	0%
2	0.32 – 0.39	4	20%
3	0.40 – 0.43	0	50%
4	0.44 – 0.48	0	80%
5	0.49+	0	100%

Questions?