Proposed Revisions to the Credit Requirements for Virtual Transactions Market

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Management Committee
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Outline

- Overview

- Recap of current credit requirements in the Virtual Transactions market

- Areas identified for improvement

- Proposal

- Impact of proposed changes on price deltas

- Shortening timeframes to suspend a Virtual Trader

Overview

◆ NYISO discussed potential changes to the Virtual Transactions Credit Requirements at the:

October 13, 2006	S&PWG
October 31, 2006	S&PWG
January 22, 2007	MIWG
February 5, 2007	MIWG
February 7, 2007	BIC

◆ The current proposal is a refinement based on the results of the above meetings

◆ MPs are generally in favor of this refined proposal.

February 21, 2007

Current Credit Requirements

- Credit requirements for Virtual Transactions as currently established in the NYISO's tariffs.

- Credit Requirement Calculation:

    (Daily Trading Limit in MWhs) x (Price per MWH) x (Factor of 2)

- Daily Trading Limit is indicated by the customer, subject to availability of adequate credit.

- Price per MWh is determined based on the difference between the Day-Ahead and Real-Time energy prices over the previous ninety days at the 97th percentile.

    Example:
    Customer A desires to trade 1,000 MWhs daily.
    Credit requirement (as of 2/11/2007) = *1,000 MWhs x $82 x 2 = $164,000*
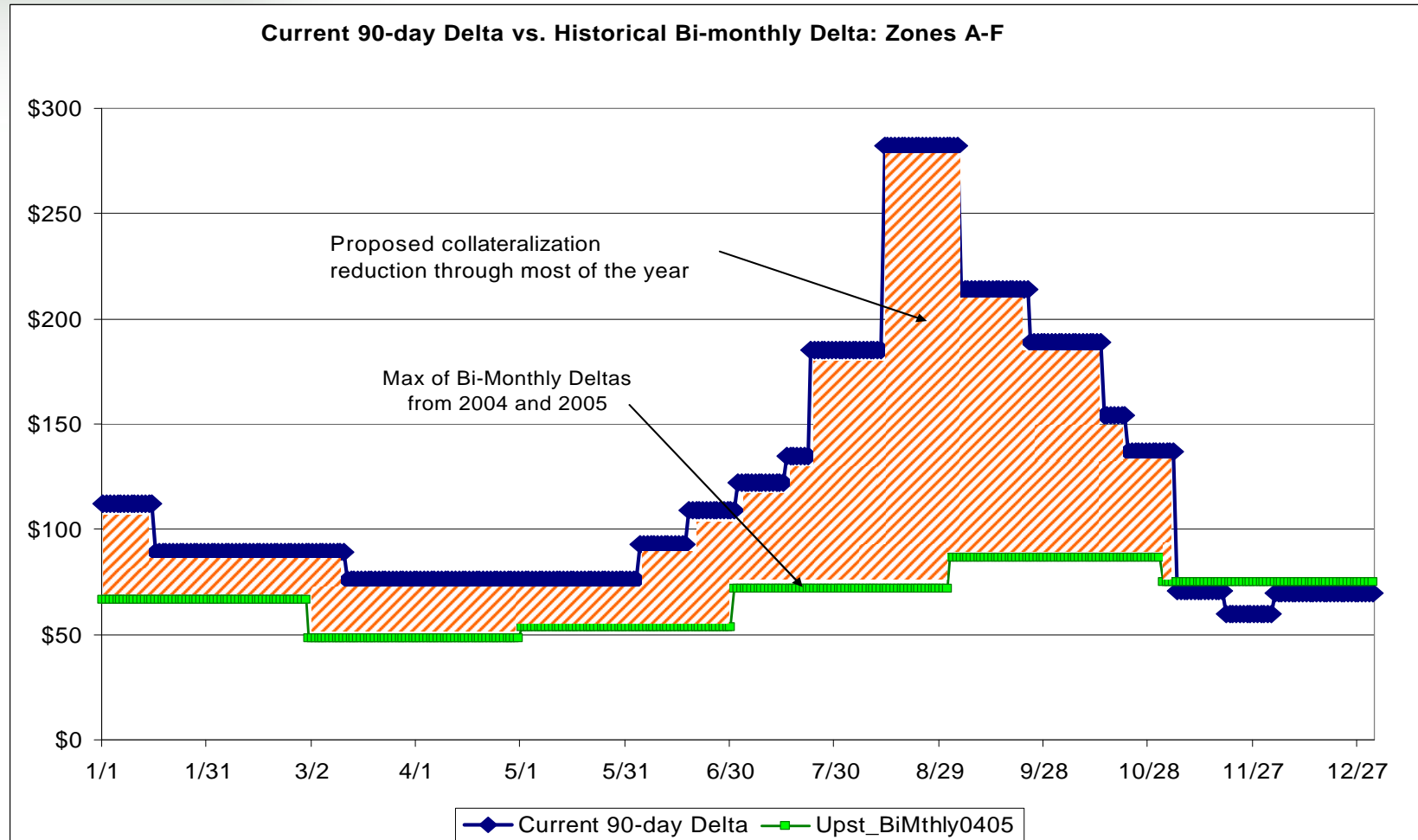
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Areas Identified for Improvement

- Virtual Traders can incur market losses that exceed collateral, generally due to unexpected market events.

- For a thinly-capitalized Virtual Trader, the risk that a market loss exceeding its credit will result in a bad debt loss is much higher than for well-capitalized Virtual Traders because the NYISO has a much better chance of successful recovery from a well-capitalized entity.

- The 90-day rolling calculation of the price differential used to establish Virtual Transactions credit requirements lags behind seasonal changes (i.e., the price per MWh can be higher than necessary in shoulder periods and lower than necessary in peak periods).

- The current time period to suspend the bidding privileges of a Virtual Trader who has exceeded its established credit creates potential exposure which could be mitigated by a shorter suspension period.

- Statistically, trading Virtual Supply is more risky than trading Virtual Load. This fact is not reflected in the current credit requirements.
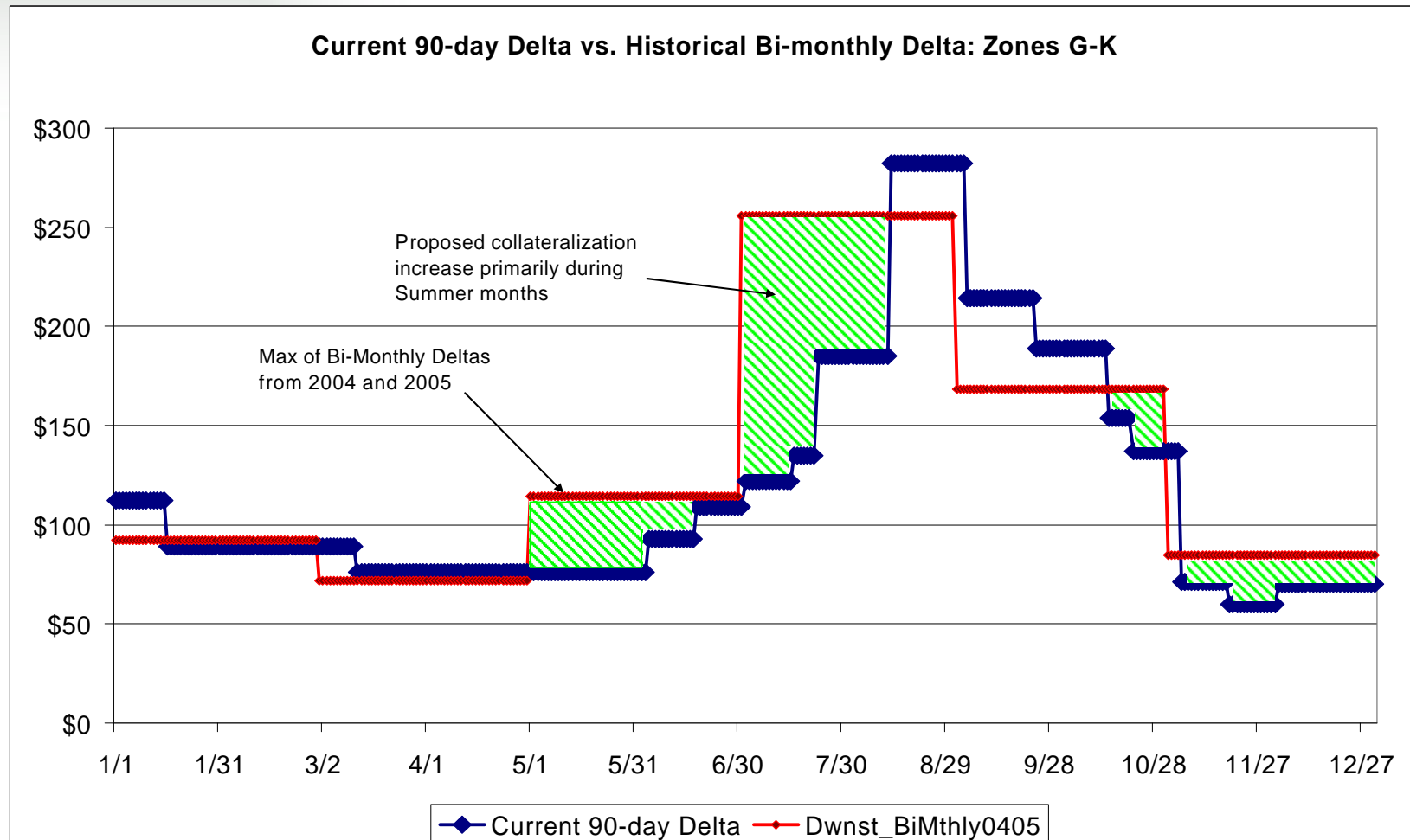
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Proposal

- Based upon MP feedback and NYISO analysis of market characteristics and MP bidding behavior, NYISO staff recommends the following refined proposal:

  - Replace the 90-day rolling with a seasonally adjusted calculation based on the higher of the maximum price differential calculated at the 97th percentile from the two prior year equivalent periods.

    - Divide the year into (6) two-month intervals [January-February, March-April, May-June, July-August, September-October, November-December] and extract the higher of the maximum price differential at the 97th percentile from the two prior year equivalent periods.

  - Determine price differentials separately for trading in each of the 11 virtual trading zones.

  - An MP's overall collateral requirement will be based upon the highest price differential in any zone in which that particular MP has elected to trade.

  - Suspension timeframes for Customers that have eroded available credit support would be shortened.

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Impact Of Proposed Changes On Price Deltas

Current 90-day Delta vs. Historical Bi-monthly Delta: Zones A-F

Proposed collateralization
reduction through most of the year

Max of Bi-Monthly Deltas
from 2004 and 2005

Current 90-day Delta   Upst_BiMthly0405

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Impact Of Proposed Changes On Price Deltas

Current 90-day Delta vs. Historical Bi-monthly Delta: Zones G-K

Proposed collateralization increase primarily during Summer months

Max of Bi-Monthly Deltas from 2004 and 2005

Legend: Current 90-day Delta — Dwnst_BiMthly0405

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Shortened Suspension Timeframes

Current Montioring Action
- The NYISO Credit Department monitors daily (including weekends and holidays) the cumulative financial position versus established credit support, for all Customers participating in the Virtual Transactions market.
- When a Customer has cumulative month-to-date virtual trading losses greater than or equal to 50% of the amount of credit required, the Credit Department will make a demand for additional credit support or prepayment in an amount equal to the entire trading loss. This demand must be met no later than the close of the next business day.
- If the Customer does not comply, its trading privileges will be suspended until such time as the Customer complies.

Current Suspension Timeframe
- If the trading loss is observed any day between Sunday and Thursday, a demand for credit support may be issued and can potentially be met during the next <u>business</u> day (i.e., anytime between Monday and Friday). If the demand is not met, NYISO will suspend trading privileges.
- If the trading loss is observed on Friday or Saturday, the earliest day a Customer can comply is Monday, which allows a trader to enter two additional days of bids and offers. If Monday is a holiday, then a trader can enter three additional days of bids and offers.

Problem
- Because the current policy requires the NYISO to provide one <u>business</u> day to comply, up to three additional days (including a Monday holiday) of trading activity can occur, for which the Customer's net loss position could further deteriorate.

Proposal
- If the NYISO observes cumulative virtual trading losses on Friday, Saturday or Sunday (if following Monday is a holiday), greater than or equal to 50% of the amount of credit support posted, then the Credit Department will issue a demand for credit support and suspend trading privileges immediately, until such time as the Customer complies.
- NYISO will institute a reporting mechanism that allows the Credit Department to determine a Customer's Virtual Transactions financial settlement prior to 5 a.m. the day after the operating day. If a Customer exceeds its established credit support by 100%, the Credit Manager will have the authority to remove any pending day-ahead bids before they are accepted for evaluation at 5 a.m. and suspend trading privileges until the Customer complies with demand for credit support.

February 21, 2007

Proposed Schedule

- Schedule & Pricing Working Group: 10/13/06 and 10/31/06
- Market Issues Working Group: 01/22/07 and 02/05/07
- Business Issues Committee: 02/07/07
- Management Committee: 02/21/07
- Board of Directors: 03/13/07
- 205 Tariff Filing with FERC   Late March