

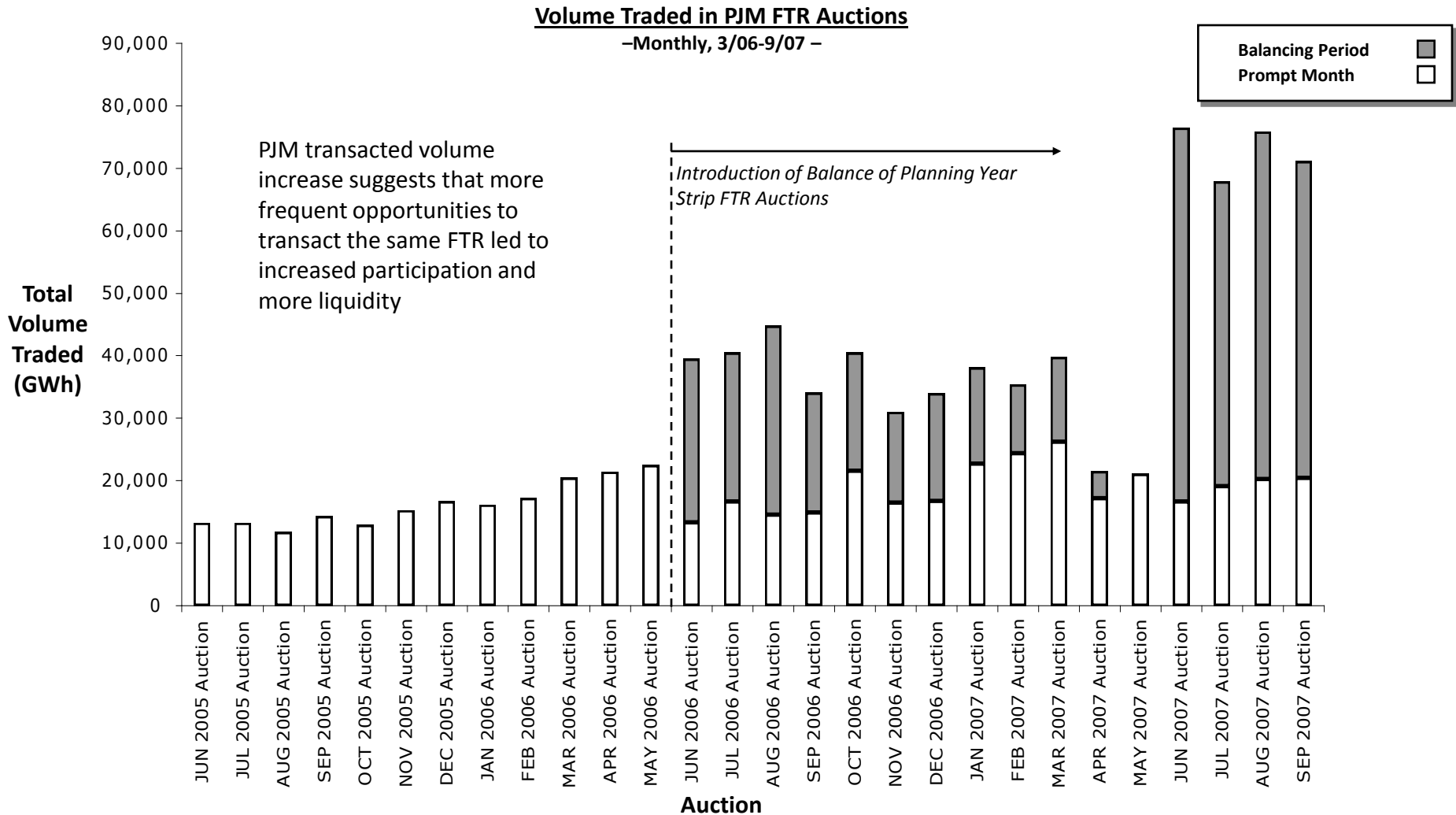
Foundation for Mitigating FTR Default Exposure: Increase the Opportunities to Transact

Recommendation of
FTR Credit Working Group
May 08, 2008

FTR Default Risk Elevated by Auction Structure

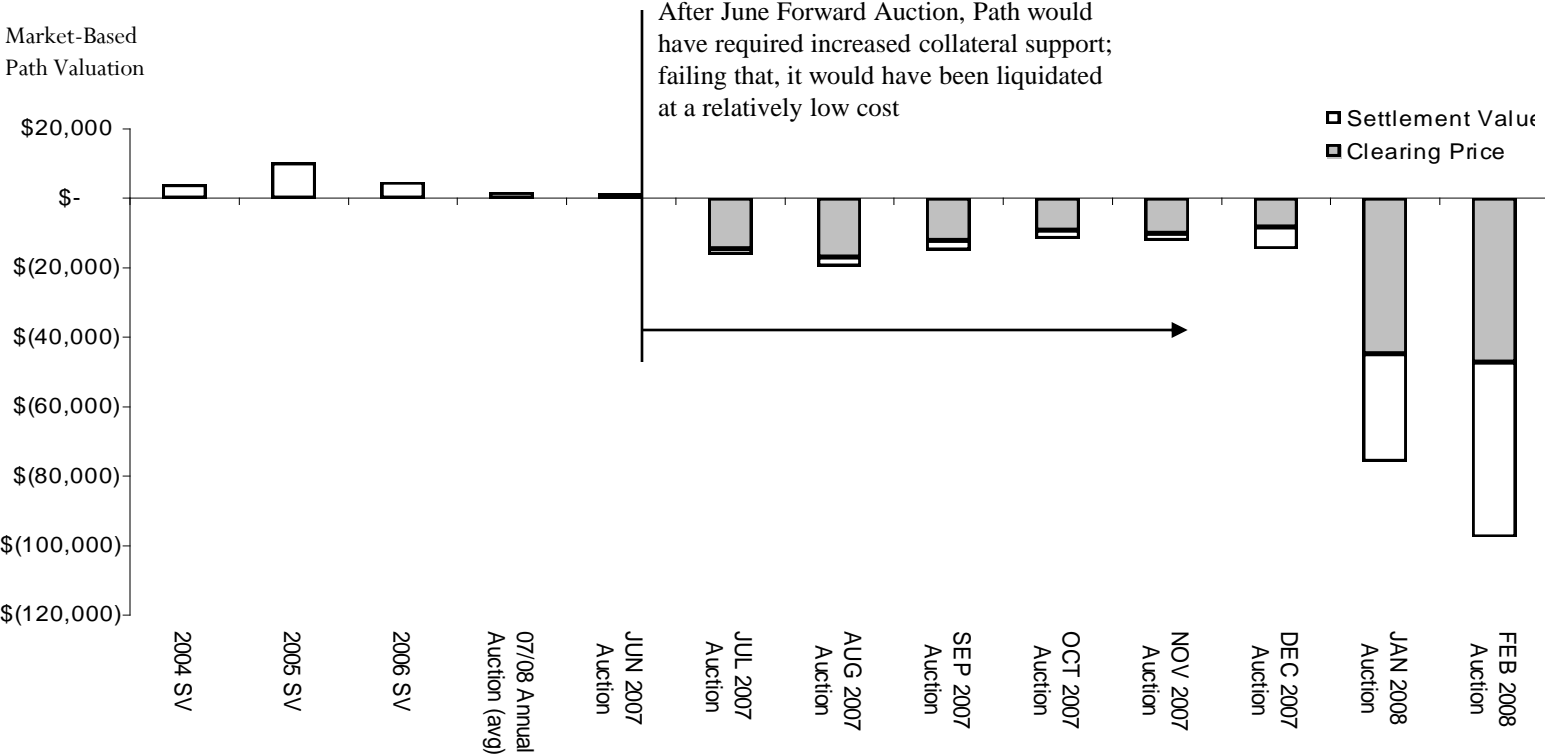
- Currently the ISO only conducts an annual auction and monthly auctions
- The current structure of FTR auctions results in limited ability to:
 - assess evolving value of held positions
 - liquidate a defaulted entity's portfolio
- Each of these aspects is highly problematic from a credit risk perspective
- No ability to “Mark-to-Market”
 - Because any particular contract can only be transacted once (i.e., annual strip only available for transaction in the annual auction), there is no ability to track the market's view of a position's changing value
 - Benefit of the use of market perception as a leading indicator in margining is void
- No viable forum to liquidate defaulted positions
 - In the case where an entity defaults, the ISO has no forum to liquidate a portfolio as FTR auctions only cover a single month at a time
 - Losses around a default can't be established until the end of the FTR term
 - In order for the ISO to limit risks from defaults, it needs to be able to liquidate a portfolio
- These fundamental issues have prompted the request to alter or augment current FTR auction structures

Transaction Volume and Increased Auction Frequency



Frequent Forward Auctions Permits Market to Provide Forward Indicator of Change in Value

Defaulting Path Valuation Evolution
 – Auction/Settlement Value from Acquisition to Default –



Suggested Enhancement to FTR Auction Structure

- Provide more frequent opportunities to transact on the same forward product
 - Provides valuable price discovery assisting in properly margining future exposure based, in part, on the market's view of a position's value
 - Provides for increased market activity thereby lowering liquidity risk
 - In the event of default, the ISO would be able to liquidate the portfolio via standard auction
- For these reasons, the FTR Credit Working Group has reached consensus in recommending the ISO enhance the structure of FTR auctions to include opportunities to re-transact on open positions