

Asset Backed Commercial Paper

Update

As identified in Exhibit B, Tab 5, Schedule 1, on page 3 of 10, it was the IESO's expectation, consistent with the expectations of all key stakeholders to the Restructuring Plan (Plan) at that time, the restructuring of the non-bank asset-backed commercial paper (ABCP) in Canada would have been implemented by the end of 2008. The restructuring was actually implemented in January 2009 and the IESO has now received the restructured notes.

In the fourth quarter of 2008, Canadian and international credit markets continued to experience significant volatility. Market conditions worsened and interest rate spreads widened. As a result of the widening of interest rate spreads, some parties to the Plan became concerned about implementation of the Plan. There was also a negative impact upon the estimated fair value of the ABCP investments in that spreads have widened. A widening of interest rate spreads means that investors are now commanding a higher rate of interest on investments of the same risk than they were at previous times. Since the interest rate to be paid on the restructured notes is fixed at Bankers' Acceptances less 0.5% any increased expectation on the part of potential investors serves to reduce the estimated value of the restructured notes.

In response to these developments, amendments were negotiated to the Plan. These amendments included federal and provincial government support. The amendments were sanctioned by Mr. Justice Campbell of the Ontario Superior Court of Justice and implemented in January 2009.

In brief, some \$4.45 billion of additional margin facilities are to be provided by the federal government, three provincial governments and a few of the larger note holders. This combined with an 18 month moratorium on collateral calls and a significant move of the spread triggers on the new notes make the likelihood that they will be tripped even more remote than the original Court approved Plan structure. These modifications and improvements to the Plan make it more robust and should add stability to the new notes.

As noted, another result of the widened interest rate spreads is negative impact on the estimated fair value of some ABCP investments, including some investments held by the IESO. Specifically, the real-time market investments and the transmission rights market investments are estimated to have a market value of approximately 63% at December 31, 2008 and the corporate investments are estimated to have a market value of 29% at December 31, 2008. As previously indicated on page 6 of Exhibit B, Tab 5, Schedule 1, the estimate of market value for the corporate ABCP holdings reflects a material portion of the underlying assets within the ABCP investments having exposure to sub-prime mortgages in the United States.

The estimated market values are based on estimated cash flows discounted at rates of returns that are estimated to be expected by an investor in the notes at that time.

Real-time Market Investments

The IESO has \$23.1 million of real-time market funds invested in ABCP. The treatment of such investments is outlined on page 7 of Exhibit B, Tab 5, Schedule 1 and was predicated on the assumption that the Plan would be implemented in 2008 with the result that the IESO would be holding the new notes at the end of 2008. Although discounted cash flows supported a higher estimated valuation, due to expected low liquidity of the notes initially after issuance the IESO had estimated a market value of 60% for these ABCP investments at December 31, 2008. As a result of the estimated valuation, the IESO had forecast zero market related investment income for 2008. Since the restructuring was not completed in 2008 and the IESO's investments remained illiquid at the end of 2008, the IESO recognized zero market related investment income in 2008.

Through the continued use of estimated discounted cash flows, the IESO is now forecasting a market value of the real-time market ABCP investments of 66% at the end of 2009. This represents a reduction of 4%, or approximately \$0.8 million, from the estimated market value of approximately 70% on December 31, 2009 within the initial filing (Exhibit B, Tab 1, Schedule 1, page 25). This reduction in estimated market value of the real-time market ABCP investments also reduces the projected market-related investment income in 2009 by \$0.8 million. As identified in the initial filing (Exhibit B, Tab 5, Schedule 1, page 9), there was and remains uncertainty as to the future value of the ABCP investments.

Corporate and Transmission Rights Market Investments

The IESO also has a corporate investment of \$1.35 million in ABCP and the IESO had established a 50% reserve in 2007. As a result of the details of the final restructuring and the deterioration in the credit market discussed earlier in this note, the IESO took a further 21% reserve in 2008.

As outlined in Exhibit B, Tab 5, Schedule 1, page 9, investment returns on transmission rights market investments remain with the transmission rights accounts and do not impact the corporate financial results and the IESO's rate application.

Going Forward

Considering the complexity of the restructured notes and the volatility of capital markets there continues to be significant uncertainty regarding the market value of the ABCP notes and interest rate assumptions on market investments. Such uncertainty may result in variances to

the budgeted market-related investment income for 2009 and for future years as long as the IESO continues to hold these investments. The level of uncertainty on the downside is limited to the amount of market-related interest income budgeted in each of the plan years since the lowest amount of market-related interest income that can be recognized is zero. Pursuant to the market rules the IESO does not have a legal or constructive obligation to make the real-time market whole or repay any investment losses and as such the IESO does not recognize a negative amount for market-related interest income. Specifically, Chapter 9, section 6.15.9 states that the "Monies in the IESO settlement accounts at the end of each year which have been earned from interest on funds in the IESO settlement accounts and which are not attributable to any incomplete settlement process or outstanding settlement dispute shall be used to off-set the IESO admin charge in the following year". Practically, however, the IESO would ultimately absorb the loss through the lack of market-related interest income until such time as interest on other market investments is sufficient to fully fund any investment loss. For further clarification, in the case of aggregate investment losses, as was the case in 2007 and 2008, there would be no monies in the IESO settlement accounts at the end of the year and, accordingly, there are no monies to use to offset the IESO admin charge and no market-related interest income would be recognized.

Inherent to the process of establishing a budget based on forecasts, variances against budget, both positive and negative, will continue. Should there be a negative variance against budget in respect of market-related interest income, whether as a result of lower interest rates or ABCP losses, the IESO may at the same time have offsetting positive variances in revenues or costs in other areas. The IESO believes the utilization of the deferral account to absorb a surplus or, as forecast for 2009, a deficit is appropriate and consistent with the IESO's deferral account as approved by the OEB.