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Mark Takahashi
Chair, PJM Board of Managers

VIA Electronic Delivery

December 9, 2021

Commissioner David Ober
President, Organization of PJM States, Inc.
PNC Center
101 W. Washington Street, Suite 1500E
Indianapolis, IN 46204

Dear President Ober,

Thank you for your correspondence dated November 10, 2021 wherein the Organization of PJM States, Inc. (OPSI) expressed its support for the utilization of a 99% confidence interval for calculating collateral requirements in Financial Transmission Rights (FTR) markets.

PJM management has been clear with stakeholders that utilization of a 99% confidence interval is its desired end state over time.[1] As you are aware, on October 20, 2021 the PJM Members voted to support a 97% confidence interval. PJM agreed that it would support an initial confidence interval of 97% at this time as part of a package that included the Members Committee endorsing PJM's new historical simulation modeling. We also agreed that if we decided to revisit the confidence interval that we would discuss that potential change with the stakeholders prior to doing so.

The shift to a simulation-based value-at-risk methodology for calculating FTR initial margin represents a significant change for our Members. Indeed, PJM is on track to be the first FERC-jurisdictional RTO to implement such a methodology. Even at a 97% confidence interval, our modeling points to significant risk reduction compared to the status quo, and collateral requirements that more accurately reflect the risk in our Members' FTR portfolios. As we and our Members gain experience with this methodology, PJM plans to assess how the historical simulation and variation margin requirements are performing and, based on that assessment, discuss any proposed future changes in the model methodology and the confidence interval with our stakeholders, including OPSI.

Ensuring strong risk management is one of PJM's highest priorities. In recent years, with the support of our stakeholders, we have taken several steps to strengthen our credit risk management capabilities. These include the hiring of a Chief Risk Officer, significantly enhancing our Know Your Customer processes, increasing our ability to require additional collateral for Members that we believe represent an unreasonable credit risk, and implementing a Mark-to-Auction approach to calculating variation margin. The implementation of this historical simulation based approach to calculating initial margin would represent yet another strengthening of protection for our Members from the risk of a credit default.

[1] *See, e.g.,* Bloczynski, Nigeria, "PJM Perspectives on Main Motion and Initial Margin" presentation to the PJM Members Committee (October 20, 2021).

We would like to thank OPSI for its thoughtful correspondence and engagement in this matter. You have helped shape our approach to risk management and we are grateful for your support.

Sincerely,

Mark Takahashi

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Chair, PJM Board of Managers