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Credit Insurance Discussion

PJM Interconnection, LLC
Risk Management Committee

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A business of Marsh McLennan

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Credit Insurance – Overview/Background

There are two common insurance risk mitigation solutions that can assist companies in addressing potential credit risks. For purposes of this presentation, and for PJM's bespoke solution, we call these collectively "Credit Insurance".

1. **Trade Credit Insurance** – designed to help address short term credit risk (tenors of 365 days or less).
   - Perils are defined around credit: (1) protracted default; (2) insolvency.
   - Exclusions exists with the most notable being "disputes".

2. **Non-payment Insurance** – designed to address non-payment risks which are contractual in nature and carry longer tenors than one year.
   - Meant to lean heavily on an underlying contract/agreement.

These types of coverages have historically been used for trade-related activities (e.g. manufacturing). Over time, the use of these coverages has evolved from purely trade related, to non-trade related (e.g. financing) purposes. As uses for these coverages evolved, insurers have had to adapt to more "atypical" scenarios and programs.

Both types of coverages are considered insurance(s) and not financial guarantee. Therefore, they carry similar characteristics which categorize them as insurance:

1. Retention: The insured party holds a share of the loss.
2. Conditional in nature: The insured party/parties need to meet certain criteria in order to receive a claim payment.
3. Subrogation: Insurers right to seek remedies associated with a claim payment.

For purposes of PJM, we are looking to create a highly bespoke Credit Insurance program. This program may carry traits from both Trade Credit and Non-payment insurance, while also bringing unique variables not present on either type of policy.

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Credit Insurance – Overview/Benefits

Credit Insurance is used by various types of companies in numerous industries. There are unique benefits for certain industries, and common benefits that apply across multiple industries:

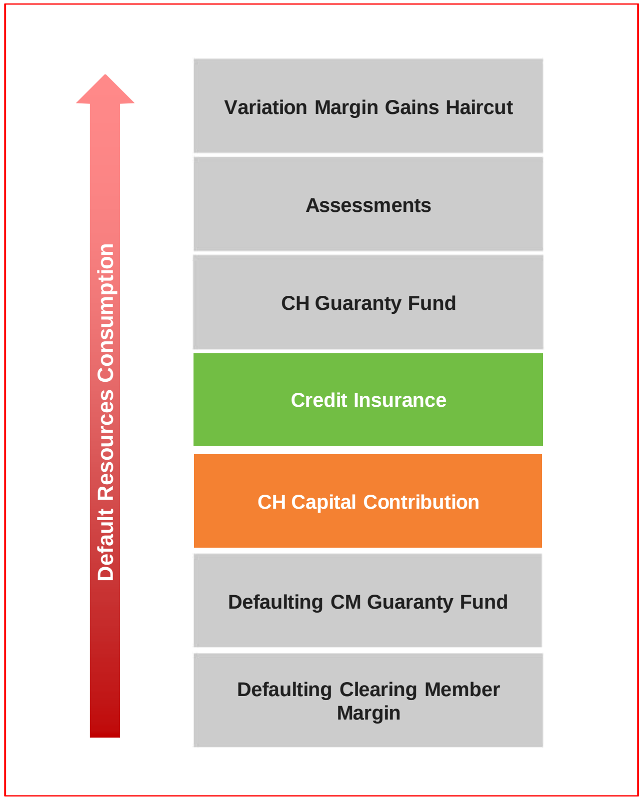
Benefit	Sample Industries
Capital Relief	Financial Institution
Bad debt reserving relief / Accounting rules changes (i.e. IFRS 9 and ASU 2016-13)	Multiple (e.g. manufacturing, electronics, commodities, chemicals)
Extending credit to customers / supporting longer payment terms	Multiple (e.g. manufacturing, electronics, commodities, chemicals)
Borrowing on more attractive terms	Multiple (e.g. manufacturing, electronics, commodities, chemicals)
Lending (More)	Financial Institutions
Decreasing contributions associated with a members default	Multiple (e.g. Co-ops, Clearing Houses)

Credit Insurance – Non-Traditional Applications

Marsh’s Financial Risk Products practice specializes in highly bespoke credit solutions. These programs are “atypical” in nature and usually require either creating a new coverage form or adapting a “conventional” product for new uses.

Non-Traditional Credit Insurance Solution Examples

- State self-insured guaranty funds
- Large deductible casualty insurers
- Clearing houses (central clearing counterparties)
- Credit card / Payment Service Providers (PSPs)
- Alternative solutions to bank portfolio risk
- Securities lending
- Residential or commercial mortgage portfolios
- Rating inefficiencies / securitizations



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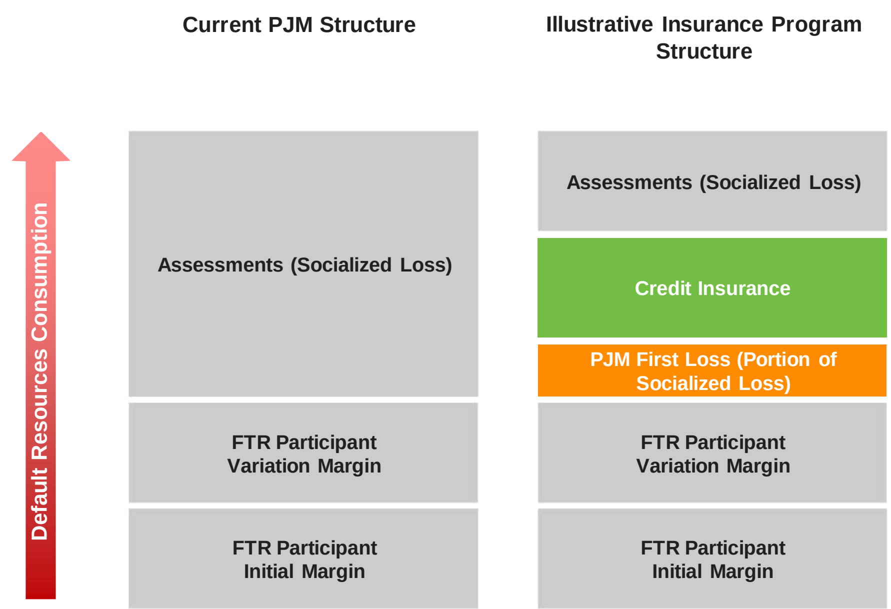
Credit Insurance – (PJM) Illustrative Structure and Market Feedback

PJM and Marsh began discussions in August 2019 around exploring the usage of credit insurance.

- Initiative inclusive of independent risk committee review of PJM's risk practices
- Additional changes to risk protocols under review by FERC
- PJM focus for insurance has been on FTR participant pool, largely driven by 2018 GreenHat default
- Marsh approached the credit insurance market in November 2020 seeking an insurance solution that would indemnify PJM in the event of a loss caused by the failure of one or more PJM members/participants to fulfill financial obligations associated with FTR Agreements
- Insurance market interest has been tepid given complex structure, lack of familiarity with risk, and inability to properly categorize risk being covered
- Two credit insurers remain interested in structuring a solution, with continued information gathering and discussions with the PJM risk team
- Insurers expressed need for PJM first loss layer to keep insurer/insured interests aligned
- Ultimate credit insurance would be a bespoke solution tailored to PJM risk



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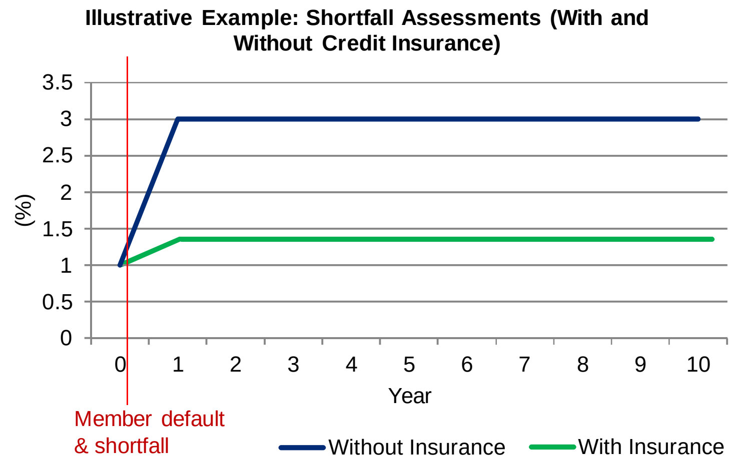
Credit Insurance – (PJM) Potential Program Benefits

The following lists some potential benefits that could be achieved through a credit insurance solution described herein:

- Reduces costs experienced by PJM members/participants via shortfall assessments following a member default
- Increases predictability for budgeting by PJM members/participants
- Displays greater strength of PJM risk management system
- Appeals to regulatory push for improved risk protocols
- Can help attract new membership



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