Use of Unreasonable Credit Risk

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Risk Management Committee

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Background

In 2020, with Commission and Stakeholder support, PJM enhanced our credit policy

- Implemented credit risk mitigation policy and procedures with a focus minimum participation requirements for Market Participants in PJM
- Established criteria PJM will use to evaluate Market Participant and Guarantor risk for participation in all of the PJM Markets
- Identified the types of documents and other information Applicants, Market Participants, and Guarantors must submit for review
- Clarified PJM's ability to request additional Collateral and/or restrict the use of Collateral posted by Applicants
- Provision for demonstrating minimum capitalization requirements and other measures of creditworthiness

Member feedback received on desirability of adding more transparency to the use of unreasonable credit risk

Unreasonable Credit Risk 2021 Summary

In 2021, PJM issued three (3) Unreasonable Credit Risk (UCR) letters to existing Market Participants totaling $14 million

Rationale:

- Degradation in overall credit quality
- Low financial score
- Material Adverse Change – significant market event led to large losses
- Decline in Guarantor's financial condition, including external rating
- Limited excess collateral to cover current market positions and inability to validate availability/sources of liquidity

Unreasonable Credit Risk 2022 Summary

In 2022, PJM issued 60 UCR letters totaling ~$94 million

New Applicants Rationale

- Low capitalization
- Lack of audited financial statements
- Low external or internal derived credit score

Potential Other Factors:

- History of financial defaults
- History of market manipulation based upon a final adjudication or legal proceeding
- History of bankruptcy or insolvency within past five years
- A future material financial liability

Unreasonable Credit Risk Summary – Existing Participants

Existing Participants Rationale

- Concentration risk caused by participant's positions in certain PJM markets
- Extreme and abnormal changes in market positions
- A combination of current market and financial risk factors such as low capitalization, a reasonably likely future material financial liability, a low Internal Credit Score and/or a low externally derived credit score
- Access to liquidity to cover current market exposure

Potential Other Factors:

- New load or unit outage information that could lead to higher operating risk
- Defaults by participant on third-party agreements
- Material Adverse Change
- A combination of current market and financial risk factors such as low capitalization, a reasonably likely future material financial liability, a low Internal Credit Score and/or a low externally derived credit score

Winter 2022/23 Planning

Credit, Trade Analytics and Markets/Operations collaborate to identify/model risk events

Assess impact to Market Participant's position/ portfolio and potential credit requirements

Credit monitoring on key impact Market Participants

Scheduling calls with participants

Reviewing collateral return request
(financial strength, size, positions, unbilled obligations, liquidity, news research, SEC filing, Rating Agency actions)

Issue UCR calls where appropriate

Use of and Return of UCR Collateral

- Excess collateral may be used to satisfy a UCR collateral call
- UCR collateral may be used to cover PMA calls during the Winter Peak
- PJM’s intent is to return the UCR collateral following the settlement of the monthly invoice unless the event persists

Contact

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Unreasonable Credit Risk

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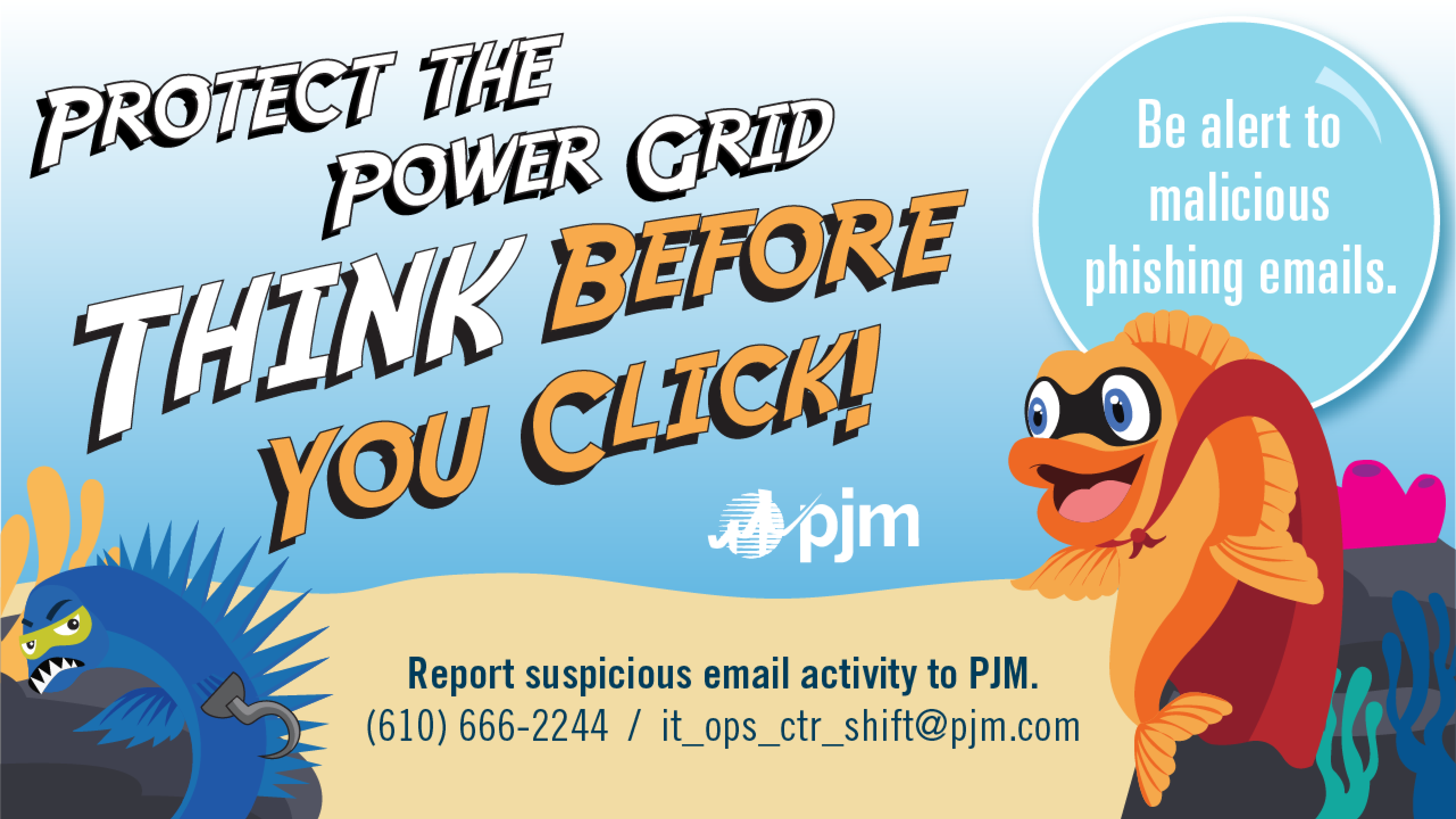
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