Summary of Stakeholder Responses to Framing Questions

FRMSTF

June 6, 2019

Q1. What criteria should be evaluated in determining whether a member application should be rejected?

Responses	#
Corporate and individual background, including prior violations, bad character, enforcement action	57
Operational/technical capability, including adequate risk management processes/controls	24
Sufficient financial capacity – Eligible Contract Participant (ECP) test ($10m in gross assets, or guarantee; $1m TNW) or similar	17
Sufficient financial capacity – strong solvency ratios	1
Sufficient financial capacity – test not specified	8
Prior trading/electricity market experience	3
Current criteria are sufficient. Do not apply stricter tests like ECP.	3
[Answer not relevant to this question]	18

Q2. How much discretion should PJM have in the rejection of an applicant, or termination of an existing member, because of unsatisfactory results in its background check, or that of its principals?

Responses	#
Complete/substantial discretion	59
Some discretion (more than today) – needs to be broken out and delineated	53
Very little discretion	5
No discretion – must follow pre-defined criteria, with no provision for unanticipated circumstances	6
[Answer not relevant to this question]	5

Q3. The Report suggests an internal appeal mechanism (C3.1). What is the right body for appeals to be made to?

Responses	#
A staff committee, including CRO	32
PJM Board	11
A stakeholder committee, e.g. composed of stakeholder risk professionals	1
A hybrid committee	34
Members Committee	2
Independent body, such as an ombudsman	24
[Answer not relevant to this question]	3

Note: Appeals to FERC are not included in the list above, as this is a right that PJM’s rules can neither grant nor remove.

Q4. What sort of test could PJM employ – beyond just confirming their existence – to form a meaningful assessment of participant risk management processes?

Responses	**#**
Conduct risk management audits – potentially utilizing third-party to conduct	71
Conduct scenario analysis/stress testing	4
Require entity to self-certify, as well as submit, its policy	10
Don’t do anything beyond confirming existence of the processes	1
Don’t evaluate – if a participant doesn’t know what it is doing, that is their problem	8
[Answer not relevant to this question]	16

Q5. Should stricter criteria be applied for participation in FTR and other financial markets, as compared to cash/spot market participation?

Responses	**#**
Yes	33
Participation criteria should be driven by the risk profile of the (expected) portfolio, rather than FTR vs. cash market	33
No	24
Your question is stupid	1
[Answer not relevant to this question]	9

Q6. What is a reasonable minimum level of capitalization in order to participate in financial markets?

Responses	#
> $50m	1
> $10m	17
> $5m	2
> $1m	7
Current minimums are sufficient	21
Shouldn’t have any – margining of positions should be sufficient	1
[Answer not relevant to this question]	37

Note: Many parties supported allowing use of a guarantor to meet the minimum capitalization requirements.

Q7. For those unable to participate directly (e.g., due to capitalization requirements) in PJM-operated financial markets, should an intermediary structure be established?

Responses	**#**
Yes	13
No	12
Believe this is better handled by the ECP structure and guarantees, rather than an FCM-like structure	2
Not Sure / Explore Further	19
[Answer not relevant to this question]	10

Note: There seemed to be difference in interpretation of this question. Its intent was not to ask whether PJM should create an intermediary, but whether a structure should be defined/created that permits the use of an intermediary. Answers that stated such a role should be left to the market are therefore treated as a 'Yes'.

Q8. Should there be formal training and certification requirements for individual traders to transact in the PJM's financial markets, akin to those applicable in most futures markets?

Responses	**#**
Yes	37
Should be based on self-certification (per FERC Order 741)	35
Any requirement should be cross-ISO	2
No	31
[Answer not relevant to this question]	22

Financial Product Scope

One way to reduce the overall size of the risk pool, and thus any potential default, would be to reduce the range of product that can be traded, in terms of both tenor and locational basis. This must be traded off against the utility provided to participants by such products. PJM wishes to understand the general opinions of FRMSTF concerning:

Q9. Should PJM continue to offer FTR auctions?

Responses	#
Yes	94
Yes, but need a review of scope	1
Only if risk is isolated to FTR market participants	7
Only if it shows demonstrable benefit to physical load	16
Neither PJM nor its stakeholders is entitled to ask this question	5
[Answer not relevant to this question]	7

Q10. Should PJM continue to offer long-term FTRs auctions?

Responses	#
Yes	70
Only if it shows demonstrable benefit to physical load	15
Not sure	1
No	25
[Answer not relevant to this question]	8

Q11. Should FTR options continue to be offered?

Responses	#
Yes	77
Only if it shows demonstrable benefit to physical load	16
Not sure	2
No	22
[Answer not relevant to this question]	3

Financial Product Scope

Q12. Should all current locations be available for financial trading? If not, which locations should trading be limited to?

Responses	**#**
Yes	82
Yes – and should offer the annual auction set in the monthly auctions	1
No – should be more reflective of physical transactions	22
No – should show demonstrable benefit to physical load	16
No – have fewer, more liquid points	7
[Answer not relevant to this question]	-

Q13. Should individual nodes require bona fide physical activity in order to be traded?

Responses	#
Yes	24
Yes – unless a concrete benefit to physical load can be demonstrated	16
Should also include future generation nodes sooner	1
No	86
[Answer not relevant to this question]	18

FTR Auction Frequency

Increasing auction frequency reduces the size of the 'worst inter-auction move' that could conceivably occur between position last being marked-to-auction (or initiated) and when it could be liquidated. This allows initial margin to also be reduced, alleviating the cashflow impact of strict credit controls. Report Recommendation F1 recommends that PJM "Include Long Term FTRs in monthly or at least bi-monthly auctions."

Q14. What is an appropriate auction frequency for different FTR tenors and expiries?

Responses	**#**
Monthly for shorter and longer-term products	26
Add an extra long-term auction, to make quarterly; or change to six bi-monthly auctions	14
Weekly auctions as prompt month approaches; or more frequently	15
No change	40
[Answer not relevant to this question]	6

Q15. Should PJM outsource the credit risk management of FTRs, and potentially other financial products, to an external clearing house. i.e., a CFTC-regulated, Derivatives Clearing Organization (DCO)?

Responses	**#**
Yes	32
No – but develop separate group within PJM for financial product trading and clearing	28
No	26
Need more information; not sure; maybe	70
[Answer not relevant to this question]	1

Q16. If external clearing is utilized, should it be mandatory or voluntary?

Responses	#
Mandatory	57
Voluntary	36
Not sure; too early to answer	3
[Answer not relevant to this question]	17

Q17. If not outsourced, should financial markets form a separate risk pool to other trading activity? i.e., with defaults socialized only amongst the participants in those markets, rather than amongst the membership as a whole.

Responses	**#**
Yes	32
Yes, but FTR participants should be isolated from defaults in non-FTR markets; similar for capacity markets	7
Yes, but only those subject to such socialization should have a say in the credit process for these markets	6
Can’t see how this would work for virtuals in the DAM	1
No	60
Needs further investigation	36
[Answer not relevant to this question]	9

Report Recommendation A4.1 suggests defining "a default as any participant that is unable to meet a monthly variation margin call within two business days."

Q18. Is two (2) days the right amount, or should it be less?

Responses	#
Two days	92
Two days with right to make sooner calls	7
One day	32
[Answer not relevant to this question]	18

Credit Risk Assessment, Collateralization and Limits

Report Recommendation B2.3 suggests "rules that give PJM discretion to deal with unanticipated market emergency events." In futures markets such discretion is common, and allows, amongst other things, imposition of 'super-margin' in response to critical events.

Q19. Under what circumstances should PJM have authority to exercise similar discretion?

Responses	**#**
Should have discretion to deal with unanticipated market emergency events	44
Should be pre-defined and limited	13
Requires further definition/investigation; not sure	33
None; discretion should not be allowed; super-margining should not be permitted	14
[Answer not relevant to this question]	13

Report Recommendation D2 recommends the establishment of position limits for FTRs, based upon both financial capacity (this is essentially a trading limit) and product tenor (to ensure no party accumulates too large a position, both for financial exposure and market manipulation reasons).

Q20. What factors should determine the size of position limits?

The answers in this area would indicate come confusion regarding what constitutes a ‘position limit’ – perhaps, in part, because of the wording of Recommendation D2, which conflates position limits with risk-based trading limits, and the financial capacity of the trader.

Position limits, in the classic sense (e.g. as utilized by the futures exchanges), are not related to an individual participant’s financial capability, but are a general protection for the market. This is the definition we will use going forward.

What Is a Position Limit?

A position limit is a preset level of ownership established by the CFTC that limits the number of derivative contracts a trader, or any affiliated group of traders and investors may own. The limits are put in place to keep anyone from using derivatives to exercise undue control on a market.

- Position limits are established to inhibit any investing entity from exerting undue control over a market.
- The limits are made with respect to total control of stocks, options and futures contracts.
- The main point is to avoid allowing anyone to manipulate prices to their own benefit while hurting others.

https://www.investopedia.com/terms/p/positionlimit.asp

Credit Risk Assessment, Collateralization and Limits

Q20. What factors should determine the size of position limits? (continued)

Responses	**#**
Should ensure that no participant [ed: portfolio?] is too big to fail	14
Potential for exercise of market power	14
Potential for large, undiversified congestion reversals	1
Liquidity and the nature of the participant (hedge or spec)	4
Can't see purpose if defaulting portfolios can't be liquidated	1
If hedging activity, then <110% of natural position. If it is a spec position, evaluate the size relative to total size of market at that node; > 25% may represent a large position.	1
Should not have position limits	17
[Answer related to trading limits, or other risk limit]	103
[Answer not relevant to this question]	2

Please note this question is being re-polled with Stakeholders as a follow-up to discussion at the 6/6 FRMSTF meeting

Q21. What criteria should be required for exemption from position limits?

Responses	#
An exemption should be defined for bona fide physical hedgers (similar to futures exchanges), to some tolerance over natural position (5-10%)	30
There should be no exemptions	37
[Answer not relevant to this question]	71

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A number of markets globally choose to impose concentration limits, related not to the financial strength of the entity, but the existential threat that the failure of a large participant could have on market financial integrity.

Q22. Should PJM introduce a concentration limit, and what should its threshold be?

Responses	**#**
Yes, but not sure what appropriate thresholds should be	17
Yes, about 25%	1
Yes, only for long-term and non-prompt FTRs; could be based on tenor, location and volume	1
Yes, should be set to a point where a defaulted portfolio could be liquidated without extreme impact to overall market liquidity	2
No	35
No, but provide periodic concentration reports	9
[Answer not relevant to this question]	1

Please note this question is being re-polled with Stakeholders as a follow-up to discussion at the 6/6 FRMSTF meeting

Credit Risk Assessment, Collateralization and Limits

PJM's FTR markets are already nominally 'fully collateralized' (within the constraints of their risk models). However, a participant who fails goes broke all-at-once, in every market. To the extent that cash market and financial market funds are comingled in settlement, being under-collateralized in one means being effectively under-collateralized in all.

Q23. Should full collateralization also be applied to cash markets (DAM, RTM, etc.)?

Responses	**#**
Yes	21
Yes, if collateral efficient	8
No	56
Worth studying, but risks are inherently different in the cash market	14
No expressed opinion; not sure	23
[Answer not relevant to this question]	11

Report Recommendation B1.2 concludes that: “Financial market member committees: voting attendees must be qualified member personnel, such as credit professionals, traders, or finance professionals, as appropriate for the committee duties.”

Q24. Is it appropriate to establish explicit skillset requirements for stakeholder process participation?

Responses	#
Yes	24
Yes, if only those players bear the risk of default	7
No	6
No for participation; yes for voting	8
Not sure	11
[Answer not relevant to this question]	11

Report Recommendation B1.3 concludes that "The number of committees involved in rule setting for financial markets should be strictly minimized to streamline decision making and assure clear accountability."

Q25. Is an existing committee appropriate for the purpose, and if so, which?

Responses	#
Re-tooled Credit Sub-Committee; no change otherwise	14
Credit Sub-Committee, but review its place in hierarchy	16
Market Implementation Committee	24
Markets & Reliability Committee	1
Members Committee	1
Not sure	23
[Answer not relevant to this question]	14

Q26. If not, what should the new committee look like, and which existing committees should it supplant in order to avoid creating more committees?

Responses	**#**
Enhance/replace the credit subcommittee	8
Not sure	18
[Answer not relevant to this question]	18