Financial Risk Mitigation Senior Task Force Phase II

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Financial Risk Mitigation Senior Task Force

FRMSTF Recommendations (Phase II)

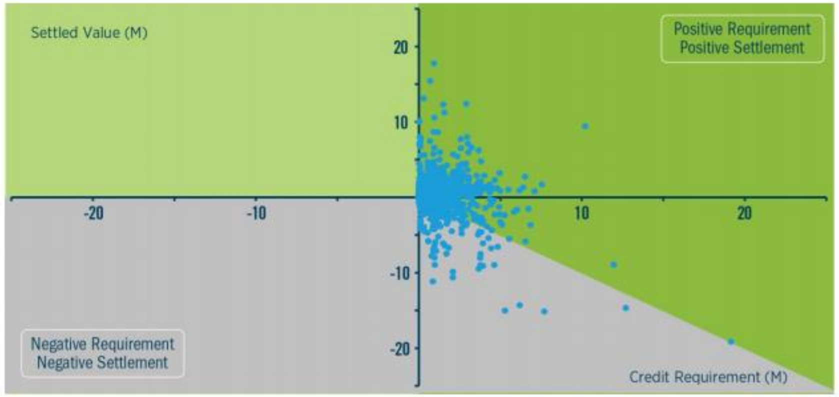
A) Advance Credit/Collateral Best Practices into the Tariff

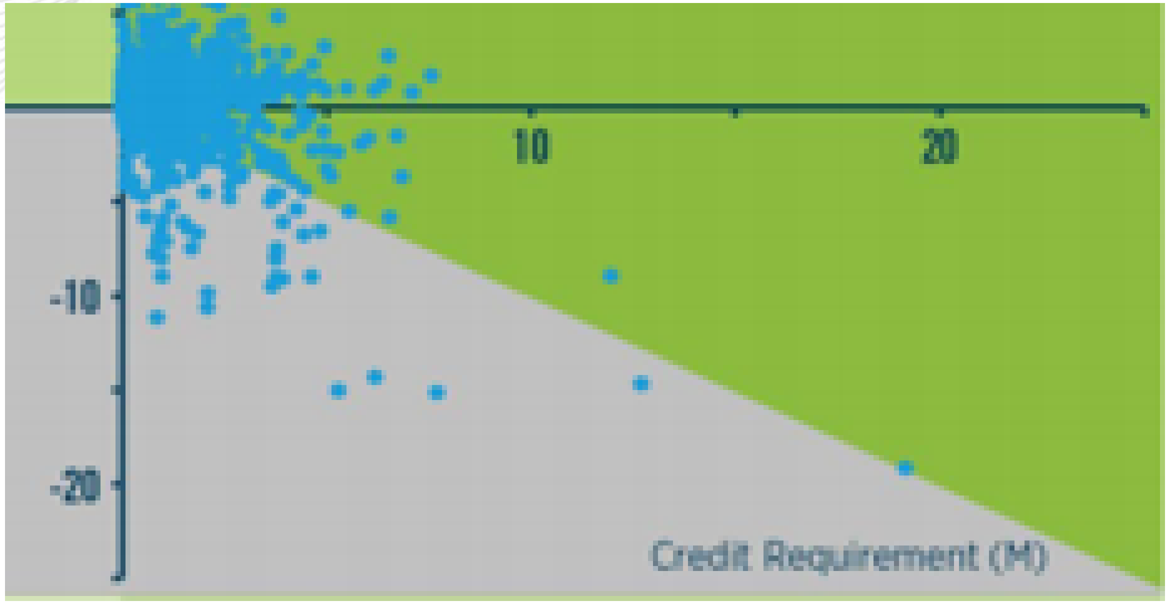
- A1) Use the mark to auction values established in the more frequent auctions (see recommendation F) as the basis for "variation margin," charging as a current debt the value erosion between the purchase price and the current market value as determined by the latest auction.
  - A1.1) This will help to capture the credit risk for all FTRs, not just near term FTRs, and reduce the current volatility of margining due to infrequent auctions.
- A2) Retain the current 10¢/MWh minimum charge, in addition to purchase price, as a form of "original margin" until such time as more precise measurements become available to determine original margin.
- A3) Eliminate the FTR undiversified adder because it is uncorrelated to market risk.
- A4) Define a default as any participant that is unable to meet a monthly variation margin call within two business days.
  - A4.1) require that the default be declared promptly and without negotiation

History

- Several enhancements to the FTR Credit Requirements have been instituted recently
  - Adjusted historical values (April 2018)
  - 10¢ per-MWh (September 2018)
  - Mark-to-Auction (April 2019)
- These enhancements have provided added protection
- However, there is still potential for additional improvement in determining risk based requirements

Current Initial Margin Compared to Settlement





- The shaded gray section indicates those monthly portfolios that had a lower credit requirement value than settled value.
- The darker green shaded section indicates those portfolios that had a credit requirement value but had a profitable portfolio.
- The lighter green section indicates those portfolios that had a negative monthly requirement value and were profitable.

Path Forward– FTR Credit Requirements

- Share preliminary data of Initial Margin Historical Simulation Methodology
- Conduct back-testing of Initial Margin Historical Simulation Methodology
- Discuss design components of a comprehensive requirement commensurate with risk
  - Undiversified adder
  - 10¢ per-MWh
- Discuss scenarios of possible Total Requirement Calculations based on design components and report on impacts to members
- Discuss FTR “freeze remedy”
- Develop proposals based on design components
- Narrow Proposals of a comprehensive credit requirement

Additional Consideration in a Comprehensive Approach

- Credit Requirements for FTR portfolios should reflect the risk associated with a potential default
  - Currently, this is considered “to Settlement”
- Investigate unwinding procedures grounded in credit best practices
- Develop an approach for unwinding a defaulted portfolio and, in tandem, align the credit requirement