

# Minimum Capitalization Requirements

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November 9, 2020



# Minimum Capitalization Concerns Expressed by Participants

Several options for changes to PJM minimum capitalization requirements were proposed in the last FRMSTF meeting. Many participants provided feedback directly to PJM expressing some primary concerns.

- PJM has taken several steps recently to protect PJM members from potential impacts of participant defaults
  - Know Your Customer due diligence
  - FTR collateral adder
  - Proposal for initial margin and maintenance margin collateral coverage
  - Other discretionary tariff tools
- Higher levels of minimum capitalization could increase costs of doing business and limit participation
- Collateral “in hand” is a much more efficient risk mitigation tool than capitalization increases
- Comparison to other RTOs is not appropriate because PJM has proposed more collateral protections

With the additional credit protection tools that PJM has implemented and is proposing, do participants think higher minimum capitalization requirements are a necessary risk mitigation tool?

- Higher capitalization “theoretically” provides higher likelihood of capital/collateral access which may be necessary to cover outer-tail market events
  - PJM and participants have both noted that capitalization is a very rough measure of creditworthiness
  - There is no guarantee an incremental increase in balance sheet capitalization will enable a participant to post additional collateral to cover exposure during extreme events
  - Access to capital is typically based on other creditworthiness factors including the ability of a company to historically generate positive cash flow/economic returns
    - PJM already has the ability to ask for additional credit assurances for “at risk” participants through other tariff provisions which are based on more accurate measures of credit risk

Some possible changes to minimum capital requirements which were considered would impact a wide group of current PJM participants

- Increase in TNW Thresholds : Of the current 197 FTR market participants who meet the current minimum capitalization thresholds the following number of participants would be negatively impacted by threshold level
  - Minimum TNW threshold of \$5 MM – 43 participants (21.8%)
  - Minimum TNW threshold of \$10 MM – 51 participants (25.9%)
  - Minimum TNW threshold of \$20 MM – 62 participants (31.5%)
- Status quo thresholds for hedgers and refine TNW for “speculators”
  - Of the 239 current FTR participants, 56% are not participating “solely for hedging purposes”
  - Of the 135 “speculators”, 81% pass current minimum capital thresholds
    - 40% would not meet \$5m TNW; 45% would not meet \$10M TNW; 52% would meet \$20M TNW



## Minimum Capitalization Options Presented at last FRMSTF

Participant feedback indicates a preference for two potential options (**highlighted**) out of the 5 options proposed at the last FRMSTF

- **Status quo – Decide PJM has enough collateral protections in place through other mechanisms**
- **Leave existing TNW threshold and remove TA threshold**
  - **Concern that some creditworthy entities with negative TNW would be impacted**
- Raise TA and TNW threshold levels from current levels
  - SPP proposal, which has been reviewed by their stakeholder group, seeks a \$20 MM tangible asset and \$10 MM tangible net worth threshold
- Raise TNW threshold and remove TA threshold
- Status quo thresholds for hedgers and refine TNW for “speculators”

## Next steps:

- After considering participant feedback, performing an analysis of potential impacts and considering the incremental benefit to making changes in minimum capitalization requirements, PJM is proposing to leave the thresholds status quo.

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## Minimum Capitalization Requirements



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