PJM Surety Bond Problem Statement

Surety Bond Problem Statement

Objective

- Initiate stakeholder discussion regarding PJM's Credit policy to consider surety bonds as an acceptable form of collateral

Potential Benefits

- Letter of credit/surety bond cost savings
- Participant collateral optionality
- Mitigating concentration risk

Support for use

- Both ERCOT and NYISO currently accept surety bonds as collateral, which Exelon now incorporates in their portfolio
- Surety bond language can be structured to be non-negotiable for market participants and/or underwriters (i.e. "One-day payment demand")

Main Concerns

- Surety bond issuers aren't open to underwriting bonds with the comprehensive language required for PJM to be protected in event of participant payment default
- Risk of delay or denial of payment by issuers in event of participant payment default

Our goal is to initiate a PJM stakeholder discussion on potentially allowing the use of surety bonds as collateral; we believe this could offer stakeholders additional optionality and potentially lower collateral costs.

Exelon.

Surety Bond Issue Charge

Key Work Activities

- Review background on Surety Bonds and the opportunity it may allow for market participants to manage their financial security with PJM
- Discuss benefits and risks associated with allowing surety bonds as a form of financial security in PJM
- If necessary, discuss associated changes to the PJM Credit Policy and other documentation

Other Details

- To be discussed at Credit Subcommittee
- Expected to be completed within 6 – 9 months
- Tier 1 Consensus

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Appendix

Surety Bond Basics

What is a surety bond?

- A written agreement where a ***surety*** guarantees the ***principal*** will live up to or perform a specific obligation with the ***obligee***.
- Due to the underwriting process with surety bonds, language can be structured to guarantee almost any obligation, no matter how complex or simple it may be. **Educating the surety on what it's guaranteeing is key.**

How is a surety bond underwritten?

- Each surety bond is evaluated by the surety on an individual basis.
- Generally, surety's consider the principal's financial profile, the bond terms (type, tenor), and the principal's bond portfolio risk profile.