



# Minimum Capital Requirements

After reviewing possible impacts to participants of raising minimum capital requirements participant feedback is required. Several options to consider:

- Option 1 – Status quo – Decide PJM has enough collateral protections in place including the 0.10 cent adder already included in the FTR participant credit exposure calculation
- Option 2- Raise MCR TA and TNW levels from current levels of \$10 MM for tangible assets and \$1 MM for tangible net worth
  - SPP proposal, which has been reviewed by their stakeholder group, seeks a \$20 MM tangible asset and \$10 MM tangible net worth threshold
- Option 3 – Leave existing TNW threshold and remove TA threshold
- Option 4 – Raise TNW threshold and remove TA threshold
- Option 5 – Status quo thresholds for hedgers and refine TNW for speculators
  - Many companies currently get Board approval to transact swaps as an “End User”
  - PJM currently collects officer certificates in which participants specify their intended market activity

Increasing the tangible net worth threshold by sizeable amounts and eliminating the tangible asset threshold would impact a large number of participants who would have to increase their capitalization level or post restricted collateral.

- 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%)



# Should PJM consider minimum capital increases?

PJM has seen extensive growth in its participant group and FTR volumes over the years

- Since 2013 FTR revenues have grown from under \$800 million per year to almost \$1.3 BN as of 2019
- Based on financial statements submitted to PJM, many market participants minimally meet the current capitalization requirements which went into effect with FERC order 741
- Balance sheet capitalization is frequently structured to meet current PJM thresholds
  - Of 197 FTR participants who meet the minimum capital requirements, 36 are passing the current tangible asset OR tangible net worth capitalization thresholds by a small margin
    - 15 (7.6%) are within \$1-\$2 million of threshold
    - 7 (3.6%) are within \$2-\$3 million of threshold
    - 14 (7.1%) are within \$3-\$6 million of threshold



# Volatility Patterns and Risk Have Evolved

Markets have seen repeated volatility shocks since the PJM minimum capitalization thresholds were established

- Polar vortex of 2014 and Corona virus in early 2020 caused substantial temporary price swings in the energy markets
- Other markets have also seen increased volatility which has prompted brokers and exchanges (CME Group, SPP) to increase margin requirements in some markets

Over the past 2 years, payment and collateral defaults have occurred primarily among participants with lower levels of capitalization

- Since 2010 there have been approximately 387 technical default notices sent to PJM participants for either payment or collateral defaults based on timing of payment/collateral posting
  - Majority defaults (305) were payment defaults
  - Vast majority of all defaults were cured
  - Most default notices likely caused by administrative inefficiencies
- Only nine of the default notices were associated with participants who submitted audited financial statements proving greater than \$5 million of tangible net worth
- Actual losses to participants have been caused by participants with large capitalization
  - Green Hat, Lehman Brothers, etc.



# Consequence for not meeting minimum capital threshold

Participants who do not meet minimum capital threshold would NOT be prohibited from participating in PJM markets

- Failure to meet the TNW threshold should result in a higher level of restricted collateral requirement
  - Before recent tariff changes PJM standard restricted collateral was \$500K plus a 10% haircut on remaining collateral if participant did not meet minimum capital requirement for FTR trading
  - New minimum capital thresholds of \$20 million for assets and \$10 MM for TNW
    - SPP has proposed a minimum deposit of \$2 MM for not meeting their new proposed thresholds for TCRs
  - SPP proposal has cleared stakeholder process and is being prepared to submit for FERC approval

## Next steps:

- Encourage feedback and suggestions from members regarding the alternatives proposed
  - Is an increase along the lines of the SPP proposal appropriate?
  - Is it more appropriate to isolate increased threshold requirements to “speculators” who may pose more risk to the markets?



Presenter/SME:  
[Daniel Sarti,  
Daneil.Sarti@pjm.com]



### Member Hotline

(610) 666 – 8980

(866) 400 – 8980

[custsvc@pjm.com](mailto:custsvc@pjm.com)