

FTR Credit Enhancement

Problem / Opportunity Statement

PJM's credit policy fails to account for various potential risk mitigants to generator ownership of FTRs. Consequently, PJM's application of the credit policy may yield generator default risk assessments associated with FTR ownership that are too high, resulting in excessive collateralization requirements for certain generator accounts.

For purposes of collateral assessment for FTR ownership, Generator accounts may merit distinct consideration due to apparent natural risk mitigants. For example, The FTR Market recognizes two categories of primary participants as determined by PJM's Minimum Participation Criteria in Attachment Q of the tariff-

Participants that transact in PJM's FTR markets with the sole intent to hedge congestion risk in connection with the rights Participant has to generate electricity in the PJM Region ("physical transactions"), and

Participants that transact in PJM's FTR markets that do not intend to hedge congestion risk in connection with the rights Participant has to generate electricity in the PJM Region

The FTR credit policy i) segregates credit for FTR trading from credit requirements in other PJM markets, and ii) does not recognize the credit risk difference between the two types of market participant described above. While it is reasonable that the credit risk policy differentiates the credit risk and commensurate collateral requirements of FTR and non-FTR market participants, it is also reasonable to recognize risk differences between types of FTR market participants. To that point, the credit risk of a FTR market participant that does not intend to hedge congestion risk in connection with generation of electricity and does not receive revenues from other PJM markets is materially different from the credit risk of an FTR market participant such as a generator that transacts FTRs for the sole purpose of hedging congesting risk and receives revenues from other PJM markets, e.g., the Energy Market. During during the normal course of market activity, PJM is typically in a net payable position to generators which that use hold FTRs to hedge congestion risk in the same account as the generation asset. MoreoverConsequently, PJM has the ability to can retain generator revenues from that account in the event of default. Further, the credit policy fails to consider the offsetting risk that a generator's physical output at the source or sink of an FTR path provides. Such inverse correlation should be considered in assessing generator default risk and required collateral for FTR ownership.

Despite those facts, in setting credit requirements for FTR market activities, generator revenues are not incorporated, nor are they considered in determining the net liquidation value. Finally, the credit risk policy does not factor that the use of FTRs by a generator for the purpose of hedging congestion represents a natural hedge, where the risk of devaluation of the FTR position is offset by the opposing physical energy position. Thus, if the value of the FTR position decreases, the value of the physical generation position increases, and vice versa, thereby offsetting the total credit risk exposure to PJM.

Tariff, Att Q - PJM's Minimum Participation Criteria

Problem/Opportunity Statement

a. Participant transacts in PJM's FTR markets with the sole intent to hedge congestion risk in connection with either obligations Participant has to serve load or rights Participant has to generate electricity in the PJM Region ("physical transactions") and monitors all of the Participant's FTR market activity to endeavor to ensure that its FTR positions, considering both the size and pathways of the positions, are either generally proportionate to or generally do not exceed the Participant's physical transactions, and remain generally consistent with the Participant's intention to hedge its physical transactions. _____

b. On no less than a weekly basis, Participant values its FTR positions and engages in a probabilistic assessment of the hypothetical risk of such positions using analytically based methodologies, predicated on the use of industry accepted valuation methodologies. _____