



Financial Risk Management Senior Task Force

FTR External Counterparty Clearing – Treasury

December 15, 2020

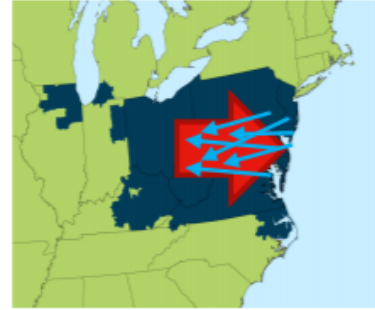
Megan Heater – Controller

Steve Lawson – Assistant Treasurer

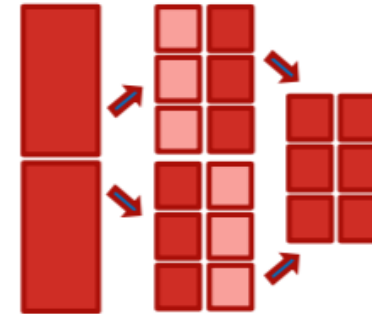


External Clearing Proposal - Overview

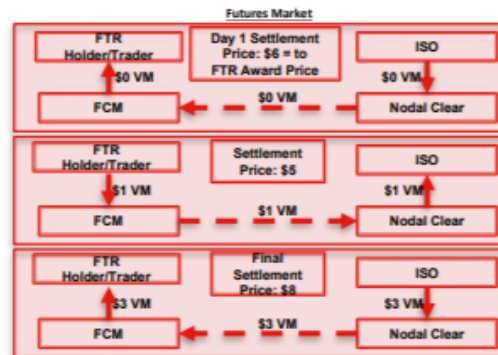
1. ISO/RTO runs FTR Auction



2. Exchange of FTRs for futures



3. Cash flows alter as futures trade and settle at Nodal Exchange



Source: Nodal Exchange

4. Risk management that reduces likelihood and impact of defaults



PJM will operate and award FTR positions under annual, monthly and long-term FTR auctions, using the current FERC-regulated auction process

- Auction participants will submit initial margin to Nodal Exchange based on projected auction bids
- PJM will provide Nodal Exchange detail of actual bids for evaluation against Nodal Exchange's calculation of initial margin

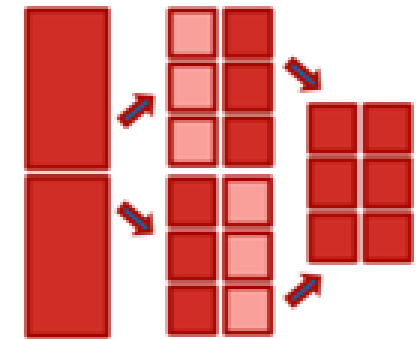


Auction participants may not meet credit requirements set by exchange clearing members.

Auction winners (FTR holders) will exchange their awarded FTR position for Nodal Exchange futures contracts via the execution of an Exchange for Related Positions called an Exchange for FTR (EFTR)

- When FTR holders exchange their FTR position, PJM Settlement, Inc. will become a counterparty in each EFTR transaction

2. Exchange of FTRs for futures



Under current proposals, FTR holders will be required to exchange their FTR position for an EFTR with Nodal Exchange.

PJM Settlement, Inc. will be responsible for daily variation margin due to/from Nodal Exchange

- Variation margin payments will be funded via a revolving line of credit taken out by PJM Settlement, Inc.

EFTR holders will be responsible for variation margin with Nodal Exchange and will be responsible for the costs of clearing FTRs, specifically settlement fees

3. Cash flows alter as futures trade and settle at Nodal Exchange



In the event that PJM Settlement, Inc. exhausts line of credit capacity, the FTR awards will be put back to the ISO through a reverse EFTR transaction.



PJM Analysis: Treasury Work Stream

Treasury

Line of credit necessary to support PJM Settlement variation margin requirements

- Modeling of line of credit sizing
- Garner interest and indicative pricing

Modeling line of credit sizing

Nodal Exchange sizing analysis is in process - final capacity required is expected February 2021

- PJM modeling to validate Nodal Exchange sizing
- \$750 million minimum line of credit likely required; this amount has been shared with potential lenders

Potential Lenders

PJM has held discussions with representatives from both current banking relationships and traditional settlement banks to garner interest in placing the PJM Settlement Line of Credit

- PJM's current banks are interested and have had continued internal discussions on structure and approach
- PJM is currently engaged in discussions with another large financial institution and there is an additional international bank with strong ties to the energy market that is actively exploring next steps

Line of Credit Structure

Based on lender discussions, below are the likely credit facility components:

- Syndicated facility which could include at least 5-10 different banks based on total line of credit capacity required
- Tenor – 2 years
- Pricing will include both drawn LIBOR (or similar benchmark) spread and undrawn commitment fees
- Transaction fees:
 - Arrangement fee – payable to lead bank
 - Up front fee – payable to each participating lender based on their respective allocations

Line of Credit Challenges

Based on lender discussions below are expected challenges:

- Size of the facility and required syndication likely leads to higher pricing than PJM has obtained in its current single bank facilities
- Complexity of the clearing arrangement and familiarity with ISO space could reduce market receptivity from potential syndicate bank participants
- PJM has limited ancillary treasury services available to attract lenders
- Relatively low usage (drawn) but large lender commitment
- Pricing is market driven; indicative pricing may not equal go live pricing

Next Steps

- Obtain Nodal Exchange's final line of credit sizing requirements – February 2021
- Continued discussion with interested lenders to obtain indicative pricing – Ongoing through February 2021
- Provide update at FRMSTF March 2021 meeting