



Proposed Changes to the FTR Undiversified Credit Requirement

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- In the Credit Subcommittee poll on alternatives to the current FTR Undiversified credit requirement adder, "Alternative 5" received by far the most support (99% support)
 - Removes the current 3X adder for undiversified portfolios
 - Increases the historical adjustment factor for historically counterflow paths to 15% from 10%
 - Retain 10% historical adjustment for prevailing flow paths
 - Increases overall membership exposure coverage ~1% in sample period
 - Decreases overall membership credit requirement ~2% in sample period

- Subsequent to the poll, PJM identified an error in the data used for the underlying analysis
- Using corrected data, PJM found that Alternative “5a” (same as Alternative 5 but with a 25% counterflow adjustment factor) provided virtually identical overall results as Alternative 5 had originally purported to provide
 - ~1% increase in overall membership exposure coverage in sample period
 - ~4% decrease in overall membership credit requirement in sample period

- PJM performed a “back test” to see how well Alternative 5a would have performed against the two portfolios underlying the \$52 million default in 2007-2008
 - Bid credit requirements would have prevented acquisition of one of the two portfolios, and would have been more than \$35 million higher for the second portfolio
 - Cleared credit requirements would have covered around 16% of the default
 - In combination, these rules would likely have reduced the default by at least half

- Additional measures, other than the undiversified credit adder, have been implemented since 2007 also provide more protection against FTR defaults
 - Calculation of credit by month rather than by year (better captures seasonality)
 - Adjustment of historical values that reduce credit requirement
 - Minimum capital requirements (or \$500,000 collateral alternative)
 - Risk management and Minimum Participation requirements
 - Disallowance of unsecured credit for FTRs

Current Requirement with Undiversified Adder	Alternative 5a
Underlying credit requirement calculation with 10% historical adjustment for prevailing and counterflow paths;	Increase the historical counterflow adjustment factor from 10% to 25% in underlying calculation.
Additional 3X price adder for Undiversified portfolios	Eliminate Undiversified portfolio adder
Targets exposure from higher cleared volumes and lower cleared prices due to bidding behavior reflecting anticipated future outages	Targets unanticipated but common exposures on paths that have been counterflow in the past (unplanned outages, weather-related congestion, ...)
Did not cover all exposures in 26-month test period	Did not cover all exposures in 26-month test period
Covered some portfolios better than Alternative 5a	Covered some portfolios better than current requirement
Would have fully covered the FTR defaults in 2007-2008	In conjunction with other changes since 2008, would likely have prevented at least half of the FTR defaults in 2007-2008
Some collateral calls during clearing	No collateral calls during clearing, since cleared credit requirement cannot exceed bid requirement
Collateral calls sometimes cause delays in clearing	No clearing delays from collateral calls
Collateral calls can cause credit uncertainty for members	No credit uncertainty from collateral calls

- PJM is asking the membership for feedback on options for moving forward
- Possible options:
 - Implement Alternative 5a with a 25% historical counterflow adjustment factor and no 3X undiversified portfolio adder in time for 2017-2018 annual auction
 - Retain the current requirements
 - Retain the current requirements but continue analysis on undiversified alternatives
- PJM will present a poll to the Credit Subcommittee after the October 31 conference call to gauge member preference for moving forward