UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

	)	
PJM Interconnection, L.L.C.	)	Docket No. ER22-703-000
	)	

COMMENTS OF THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 211 of the Commission's Rules and Regulations, Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor ("Market Monitor") for PJM Interconnection, L.L.C. ("PJM"), submits these comments responding to the filing submitted by PJM Interconnection, L.L.C. ("PJM") on December 21, 2021. PJM is proposing to change how it determines the initial margin deposit for FTRs from a method based on historical averages to one based on an historical simulation analysis model (HSIM). PJM's proposal should be accepted, with a modification. The Market Monitor supports the proposal and recommends that it be accepted and that PJM be directed to raise the confidence interval to 99 percent from 97 percent, based on industry standards. PJM's proposal, as filed, is a significant improvement over the status quo.

I. COMMENTS

A. Background

PJM is proposing to replace one part of the credit requirement for FTRs that is currently based largely on a simple weighted average historical FTR value, with an initial margin value based on a value at risk confidence interval derived from an historical simulation analysis model (HSIM).

PJM's proposed value at risk approach (VAR) based on HSIM would determine the initial margin requirement based on historic FTR price movements in FTR auctions. Using the results of the HSIM analyses, PJM proposes to use a 97 percent confidence interval when determining the initial margin for each FTR portfolio. This means that, based on historical data, there would be a 97 percent probability that the resulting initial margin would be sufficient to cover potential default costs. Put another way, setting the initial margin based on a 97 percent confidence interval means that there would be a 3 percent probability that the resulting initial margin would not be sufficient to cover potential default costs and that PJM members would be required to pay default costs.

B. PJM's Proposal Should Be Accepted with a Modification.

The Market Monitor supports PJM's proposal to use an HSIM based value at risk approach to replace PJM's current approach. The other critical element of the PJM proposal is a choice about the degree of protection, i.e., the degree of statistical certainty that the level of the initial margin will exceed the amount of a loss in portfolio value over the relevant period. The confidence interval is the metric for expressing that desired level of statistical certainty.

While the Market Monitor supports PJM proposed analytical method, the Market Monitor recommends that PJM use a 99 percent confidence level for setting its initial margin requirements rather than the 97 percent proposed by PJM.

As PJM notes (at 17-18), the VAR approach using HSIM is an industry standard approach for determining initial margins and other capital requirements for central counter party exchanges. However, the industry standard for the confidence interval used in conjunction with this approach in practice is 99 percent or higher (PJM at 22), not 97 percent.

While PJM states (at 23) that it intends to propose to move from a 97 to 99 percent confidence interval in the near future, PJM asserts (at 22) that an initial confidence interval of 99 percent would be disruptive to the market as it is expected to require higher initial margins than the 97 percent confidence interval. PJM states (at 23) that moving from the current method to an initial margin based on a 99 percent confidence interval would "shock the market system and possibly force some market participants to unwind FTR positions or to decide not to continue to participate in the FTR auctions and FTR markets entirely." PJM provides no support for this claim. PJM does not explain why market participants who cannot provide the collateral to cover the risks of their positions should remain in the market.

The purpose of PJM's adoption of the initial margin approach is to provide PJM, and the market, assurances that defaults will not disrupt the PJM FTR market. FTR defaults are disruptive. FTR defaults occur when market participants do not have sufficient collateral to cover their losses. The use of a 97 rather than a 99 percent confidence interval for determining initial margin requirements would mean that market participants will not be required to internalize a significant portion of the cost of their portfolio's potential default risk. Relative to an initial margin based on a 99 percent confidence interval, an initial margin based on a 97 percent confidence interval provides a subsidy of collateral related costs for FTR market participation at the expense of potential default costs imposed on the entire membership. Collateral costs that are not internalized by the FTR market participant are, by definition, costs imposed on the rest of the membership. Markets work most efficiently when risks are borne by those in the best position to manage them. In this case, the risk of default should be borne by the FTR holders who benefit from their FTR positions and not by PJM members more generally who have nothing to do with other FTR holders' positions. Any potential transition issues should be handled in this filing and the timing of the adoption of the 99 percent confidence interval should be included in the tariff to provide certainty for all participants. PJM's plan to propose to increase the collateral requirements at an uncertain date in the future is inferior to setting a specific date now because PJM's proposal would create rather than resolve uncertainty.

II. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to these comments as the Commission resolves the issues raised in this proceeding.

Respectfully submitted,

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Dated: January 18, 2022

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Eagleville, Pennsylvania,
this 18th day of January, 2022.

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