Issues with PJM’s Default Management Proposal

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PJM’s Request

• PJM requests unlimited discretion to manage defaulted positions.
PJM’s Request

• PJM wants to have the discretion to pick the “prudent and practical” path from a number of options (“including but not limited to”) (September 17 MRC):
  • Closing out (presumably elimination, per MMU proposal)
  • Auctioning off portions of the portfolio across several regular auctions (similar to PJM’s pre December 2018 process)
  • Conduct one or more special FTR liquidation auctions.
PJM’s Request

• PJM states (September 17 MRC) that the goal of its discretionary approach would be to:
  • Minimize losses for non-defaulting participants
  • Limit significant price disruptions to the market
  • Taking into consideration: “Liquidity, Volatility, Size of the Portfolio, other market factors”
Unlimited Discretion is Not Appropriate

• PJM does not propose rules defining how PJM would determine what is “prudent and practical” for any specific default event.

• The metrics for liquidity, volatility, size of the portfolio, other market factors have not been defined.

• The way in which such metrics would be evaluated and applied in the decision making process has not been defined.

• PJM has not explained how it would value different objectives if they conflict.
Unlimited Discretion

• Without defined, reviewed and approved rules, there is no way to determine whether the decision making process used to pick an option or a set of options will:
  • Be prudent
  • Be practical
  • Recognize tradeoffs
  • Favor one set of participants
  • Be applied consistently
ISO/RTO Best Practices

• Best practices in ISO/RTOs is to use a defined rule(s) approved by FERC.
  • Defaulted positions go to settlement is the most common rule.
• Best practices in ISO/RTOs is not to have discretion.
CCP Best Practices: Risk Management

• Fundamental best practice in CCP industry (based on PJM discussion and industry papers) is consistency.

• Consistent approach to risk management:
  • Onboarding criteria and creditworthiness standards
  • Effective risk controls and processes
  • Effective default management practices
  • Margining requirements

• PJM and the stakeholders are working on implementing consistent approach to risk management
  • Rule based, nondiscriminatory
CCP Discretion Not Applicable to PJM

• PJM cite CCP12 paper as basis for CCP discretion in managing defaults across different products. The paper defines goals rather than actual practices.
• PJM concludes that PJM needs discretion in managing defaults for FTRs.
• PJM does not recognize the fundamental differences between CCPs and PJM.
  • CCP has its own assets at risk.
  • PJM does not.
PJM’s Proposal Not Required for Margining

• PJM’s proposal does not create certainty.
  • Does not eliminate volatility
  • Does not define the holding period
• PJM’s proposal is not required in order to discuss initial margining.
• To create certainty, rules governing a default management process need to be defined.