PJM's Minimum Capitalization Requirement:

Framing the Role, Purpose and Rationale for Threshold Updates

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Overview

What is PJM's minimum capitalization requirement?

How does it differ from other credit tools?

Why revisit it now?

What principles guide potential updates?

Minimum capitalization is a foundational credit policy tool.

- Distinct from collateral and dynamic credit tools
- Functions as a financial screen, not a risk-adjusted measure
- Establishes basic financial health before market entry

Screening vs. Collateral Tools

Minimum Capitalization

- Static, binary, prequalification requirement
- One-time check (at entry and annually)
- Not tied to market activity or exposure

Other Credit Tools

- Dynamic, exposure-based (collateral, margining, scoring)
- Adjust in real-time to risk
- Address performance risk after market entry

Defined in Tariff Attachment Q, Section III.D.1:

FTR participants: at least $1M tangible net worth or $10M tangible assets

- **All others:** at least $500k tangible net worth or $5M tangible assets
- **Alternative:** post restricted collateral (not available for other obligations)

Timing & Scope

Applies at entry and annually thereafter

Does not fluctuate based on trading activity or scoring

Purpose: Establish financial capacity *before* taking on market risk.

FERC Order No. 741

Required all RTO/ISOs to adopt **minimum participation criteria**

Emphasized **adequate capitalization and risk management**

Goal: Protect markets from systemic risk of undercapitalized entrants.

Intent of the Rule

Entry screen, not substitute for collateral or credit controls

Designed to filter out high-risk participants upfront

- PJM’s rule implemented and approved in 2011.
- Thresholds have not changed in 14 years.

Why Revisit Now?

- ✓ **Markets have grown in scale, complexity and participation.**
- ✓ **Inflation has eroded the real value of fixed dollar thresholds.**
- ✓ **Participant pool includes a diverse mix of business types and sizes.**
- ✓ **Some may meet the letter of the rule but lack real financial resilience.**

PJM has emphasized **risk management and compliance.**

- But those obligations require real financial capacity.
- Thinly capitalized entities may "comply" on paper but fail under stress.
- Minimum capitalization helps establish obligations rest on solid ground.

Capital adequacy supports a participant's ability to:

- Respond to collateral calls
- Withstand price shocks or market stress
- Avoid default escalation or downstream impacts

It reinforces – not replaces – PJM's dynamic credit protections.

Striking the Right Balance

FERC warns against unnecessary market entry barriers.

But also expects meaningful participation criteria.

Minimum capitalization balances:

Open access	Market integrity	Protection from mutualized default risk

Conclusion

Minimum capitalization remains a critical entry screen.

It's not about predicting failure – it's about establishing readiness.

PJM proposes a threshold update to:

- Reflect market reality.
- Reinforce prudent risk management.
- Keep essential protections relevant.

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PJM's Minimum Capitalization Requirement

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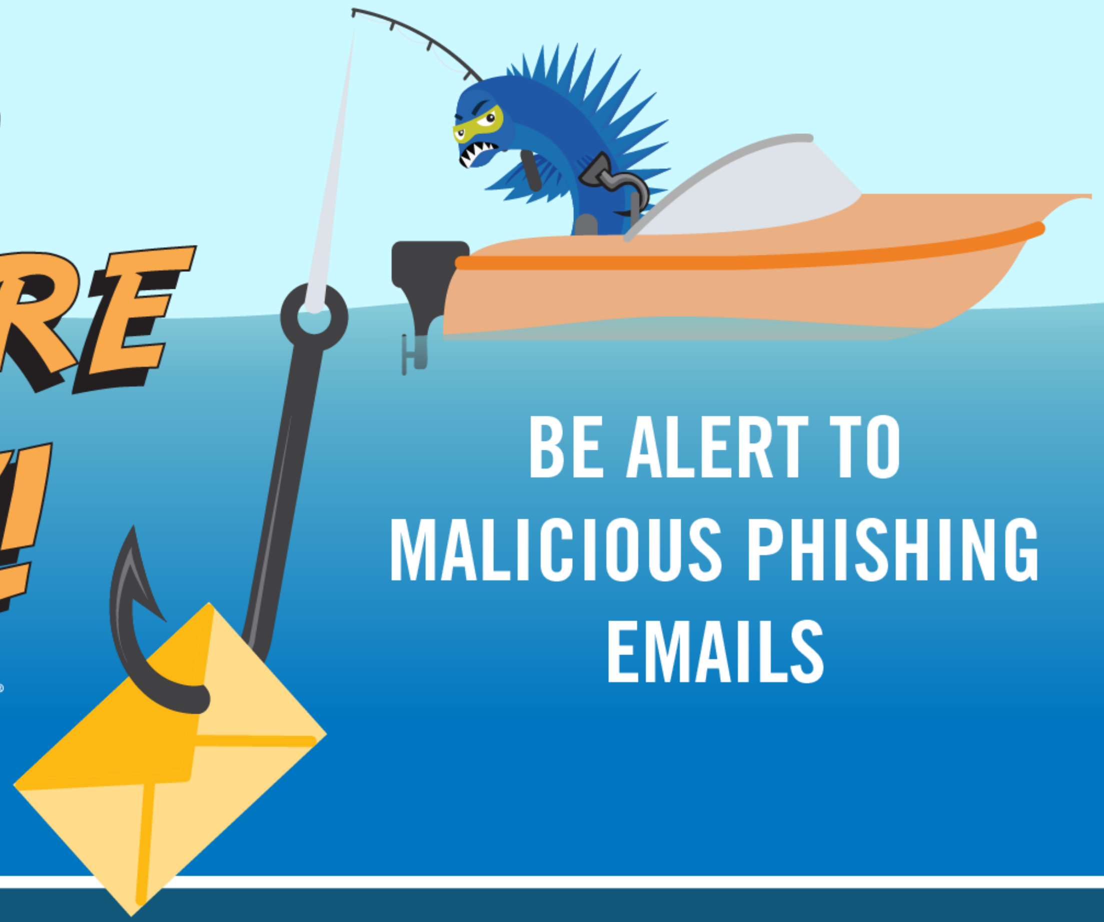

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