# Strengthening PJM's Minimum Capitalization Requirement

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August 2025

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PJM's minimum capitalization requirement is a foundational element of its credit policy. It plays a distinct and proactive role: unlike collateral and exposure-based tools, it requires that market participants meet basic financial thresholds **before** qualifying to participate in the market. While PJM's other credit protections adapt to ongoing risk, minimum capitalization acts as a **screening mechanism**, preventing under-capitalized entities from introducing risk in the first place.

The current thresholds have remained unchanged since PJM implemented the rule in 2011. In light of market growth, inflation and evolving expectations for participant risk management, PJM proposes that the time has come **to update the monetary thresholds in a targeted and calibrated manner**. The goal is not to raise barriers unnecessarily, but to preserve the rule's integrity and relevance in today's environment.

## *A. The Distinct Role of Minimum Capitalization*

PJM's minimum capitalization requirement, set forth in the PJM Tariff, Attachment Q, section III.D.1, establishes fixed financial criteria for market participation:

- **FTR Participants:** greater than or equal to $1 million tangible net worth (TNW) or $10 million in tangible assets (TA)
- **All other participants:** greater than or equal to $500,000 TNW or $5 million TA
- **Alternative:** posting restricted collateral that is not available to meet exposure-based collateral requirements

This requirement applies upon application and annually thereafter. **It does not vary based on trading activity, exposure or credit scoring**. Its role is to ensure that every participant starts from a baseline of financial stability – **before they pose risk to the market.**

### 1. How It Differs From PJM's Other Credit Tools

PJM's broader credit policy includes a range of tools designed to manage real-time and evolving risk:

- **Collateral requirements** based on Peak Market Activity and specific product exposures (e.g., FTRs, RPM, virtuals)
- **Unsecured credit allowances** based on credit ratings or PJM's internal scoring
- **Mark-to-auction and margining** to reflect market movements
- **Ongoing financial reviews** and collateral calls under Tariff, Attachment Q, section II.E for deteriorating credit conditions

These tools are transaction-based and adjusted in response to a participant's risk level. Minimum capitalization is different: It is static, binary and preemptive. It does not replace those tools – it reinforces them by ensuring that participants begin with adequate financial footing.

### B. Regulatory Foundation in FERC Order 741

PJM's minimum capitalization rule was developed in response to FERC Order 741, which required all RTOs and ISOs to establish minimum participation criteria following the 2008 financial crisis. As FERC explained:

> *The Commission is persuaded that each ISO and RTO should include in its tariff language to specify minimum participation criteria to be eligible to participate in the organized wholesale electric market, such as requirements related to adequate capitalization and risk management controls. This will help protect the markets from risks posed by under-capitalized participants or those who do not have adequate risk management procedures in place. Minimum criteria for market participation could include the capability to engage in risk management or hedging or to out-source this capability with periodic compliance verification, to make sure that each market participant has adequate risk management capabilities and adequate capital to engage in trading with minimal risk, and related costs, to the market as a whole.*

*FERC Order No. 741, 133 FERC ¶ 61,060 at P 131 (2010)*

These minimum participation criteria were to function as entry screens – not substitutes for exposure collateral – and FERC expected each RTO to set meaningful thresholds. PJM's compliance filing was approved in *PJM Interconnection, L.L.C.*, 136 FERC ¶ 61,190 (2011), Docket No. ER11-3972-000.

### C. Why an Update Is Appropriate Now

The thresholds adopted in 2011 were appropriate at the time and have served PJM and its members well. But over the past 14 years:

- PJM's markets have expanded significantly in scale and complexity.
- Inflation has eroded the real-dollar value of the thresholds.
- Market participants now include a broader mix of entities, including some that may meet formal obligations while lacking underlying financial resilience.

PJM is not seeking to make the requirement more restrictive than necessary. PJM is proposing to recalibrate it so that the thresholds continue to serve as a meaningful screen for capitalization, and the protection that they were designed to provide can remain effective.

### *D. Striking the Right Balance*

Any adjustment should preserve the rule's preventative value while avoiding unnecessary burden on legitimate participants. The focus is not exclusion – it is credibility. As FERC explained in Order 741:

> *The Commission has always been wary of unnecessary barriers to entry to market participants, with a goal of ensuring sufficient participation, adequate liquidity, and competitive results. However, this consideration must be balanced with protecting the market from risks posed by under-capitalized participants without adequate risk management procedures in place. Having minimum criteria in place can help minimize the dangers of mutualized defaults posed by inadequately prepared or under-capitalized participants.*

*FERC Order No. 741, 133 FERC ¶ 61,060 at P 123 (2010)*

In recent years, PJM has placed greater emphasis on the operational, compliance and risk management responsibilities of market participants. But these requirements are only meaningful if the entity behind them has the financial capacity to uphold them. A thinly capitalized company may appear to meet PJM's standards "on paper," but its ability to absorb shocks or deliver on obligations under stress may be illusory. **Minimum capitalization ensures these broader obligations rest on a financially credible foundation – not just a set of attestations on paper.**

**In addition, adequate capitalization is essential to a market participant's ability to meet financial obligations as they arise – particularly in response to collateral calls and credit-related requirements.** A participant with insufficient capital may lack the liquidity or flexibility to satisfy a collateral demand triggered by price movements, auction results, or deteriorating credit conditions. This not only increases the likelihood of default but can also force PJM to take protective measures, including limiting activity. By requiring that participants begin with a baseline of financial strength, the minimum capitalization rule supports the integrity of the broader credit framework and reduces system strain during periods of market volatility.

### *E. Conclusion*

Minimum capitalization remains a critical component of PJM's credit framework. It is not about predicting future failure – it is about ensuring that all participants have the minimum financial capacity to be in the market at all.

An update to the monetary thresholds would reflect today's market realities, reinforce PJM's commitment to prudent risk management and uphold the policy vision articulated by FERC. It is a measured and responsible step to protect the system – not by increasing burdens, but by keeping essential protections relevant.