



# Market Participant Minimum Capitalization Proposed Solution Packages

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## Why were minimum capitalization requirements put in place?

- FERC Order 741, issued in 2010, aimed to improve credit practices in organized wholesale electric markets, particularly to reduce the risk of mutualized default.
- ISOs were required to establish market eligibility criteria for participation in the ISO market.
- The Commission supported the ISOs imposing capitalization thresholds that address market risk without unreasonably preventing market entry.

## Why is min cap on RMC work plan?

- Thresholds are unchanged since effective date in 2011.
- Economy/Markets have significantly changed over the past 14 years.
- PJM has observed some MPs not growing their balance sheets and also an increase in new applicants that barely meet the min cap thresholds, thus requiring PJM to rely on UCRs\* and tenor limits after the fact.

## Why is minimum capitalization important?

- A company that is adequately capitalized will have financial resources to:
  - Support its operations, including robust risk management and compliance functions.
  - Invest in growth.
  - Weather unexpected challenges.
- Equips business to meet its obligations because it has necessary financial cushion to absorb unexpected costs or downturns in revenue.
- Adequately capitalized companies are less likely to become insolvent or bankrupt, as capital reserves can be used to meet obligations during periods of financial stress.

**\*UCR** – Unreasonable Credit Risk

# Proposed Solution Packages

# Comparison of RMC Minimum Capitalization Packages

Capitalization Packages			Alternative Security	Meet	Doesn't Meet	Collateral Required (000s)
Status Quo	FTR	TNW \$1MM or TA \$10MM	\$1M	95%	5%	\$23,500
	Other	TNW \$500,000 or TA \$5MM	\$500k			
Package B	FTR	TNW Must Be > \$0 and TNW \$2MM or TA \$10MM (FTR)	\$1M	82%	18%	\$87,000
	Other	TNW \$1.5MM or TA \$5MM (Others)	\$500K			
Package D	FTR	TNW Must Be > \$0 and TNW \$2MM or TA \$10MM (FTR)	\$2-3MM	83%	17%	\$188,500
	Other	\$1MM per Mkt or TA \$5MM (Others)	\$1M per Mkt, Max \$3MM			
Package A	All	TNW Must Be > \$0 and TNW \$5MM or TA \$10MM	\$5MM – TNW	77%	23%	\$788,143
Package E	All	TNW Must Be > \$0 and TNW \$1MM or TA \$10MM w/TNW adjustment \$200,000 per/yr. for 5 yrs.	\$1MM	84%	16%	\$128,000
Package F	FTR	TNW Must Be > \$0 and TNW \$2MM or TA \$10MM	FTR \$2MM – TNW	83%	17%	\$145,476
	Other	TNW \$1MM or TA \$5MM with Annual CPI Adjustment	Other \$1MM – TNW			
Package C	FTR/Virtuals – Status Quo		FTR 1MM	84%	16%	\$75,000
	Others	TNW > max(500k, 2* highest weekly bill) or TA > max (5MM, 10* highest weekly bill)	Other \$500K			
B	Lack of an incentive for participants to grow their balance sheet due to alternative security is identical to status quo			A	Highest amount of MPs not meeting and highest collateral posted	
D	Requires continuous monitoring of participant's activities			F	Two-tier approach with yearly inflation adjustment	
E	Provides a transition period to grow balance sheet, minimize market disruption and minimal financial impact to participants			C	Impacts all participants (large or small), no incentive to grow their b/s; alternative security is status quo	



# Primary Reasons Market Participants Not Meeting Requirements

Increase over status quo in market participants not meeting minimum capitalization requirements under proposals is primarily due to requirement that TNW must be  $> 0$ , even if TA meets the threshold.

## Generators:

- Negative equity position
- Large intangible assets reporting on balance sheet

## LSEs:

- Negative equity position
- Large restricted asset (i.e., security accounts held outside of PJM)

## Financial Traders:

- Small balance sheets (equity position of \$1MM–\$3MM)
- Tangible assets below the thresholds

## Power Marketers:

- Negative equity position
- Restricted assets

# Appendix



# Comparison of Minimum Capitalization RMC Packages

					Proposed Solution:					
Status Quo					#1 – Package B			#2 – Package D		
TNW \$1MM or TA \$10MM (FTR) TNW \$500,000 or TA \$5MM (Others)					TNW Must Be > \$0 and TNW \$2MM or TA \$10MM (FTR) TNW \$1.5MM or TA \$5MM (Others)			TNW Must Be > \$0 and TNW \$2MM or TA \$10MM (FTR) TNW \$1MM per Mkt or TA \$5MM (Others)		
Alternative Security FTR \$1M/ Other – \$500K					Alternative Security FTR \$1M/ Other \$500K			Alternate Security FTR \$2–3MM/ Other – \$1M per Mkt, Max \$3MM		
Total	Doesn't Meet		Collateral Required (000s)		Doesn't Meet		Collateral Required (000s)	Doesn't Meet # Doesn't Meet %		Collateral Required (000s)
	#	%			#	%		#	%	
Generation Owner/ Transmission Owner	359	12	2%	\$6,500	43	5%	\$24,500	43	5%	\$61,500
Load Serving Entity	103	8	1%	\$4,500	40	5%	\$22,500	38	5%	\$63,500
Curtailement Service Provider	25	6	1%	\$3,000	14	1%	\$7,000	14	1%	\$11,000
Financial Trader	129	10	1%	\$7,000	24	3%	\$16,500	13	2%	\$7,000
Power Marketer	134	4	0%	\$2,500	21	3%	\$12,000	19	2%	\$31,500
Other	48	0	0%	\$0	5	1%	\$4,500	6	1%	\$14,000
<b>Total</b>	<b>798</b>	<b>40</b>	<b>5%</b>	<b>\$23,500</b>	<b>147</b>	<b>18%</b>	<b>\$87,000</b>	<b>133</b>	<b>16%</b>	<b>\$188,500</b>

Collateral required is the total amount MPs that do not meet the min cap threshold would post.

**Solution 1** – lack of an incentive for participants to grow their balance sheet due to alternative security is identical to status quo

**Solution 2** – requires continuous monitoring of participant's activities





# Comparison of Minimum Capitalization RMC Packages

## Proposed Solution:

		Status Quo			#3 – Package A			#4 – Package E			#5 – Package F			#6 – Package C		
		TNW \$1MM or TA \$10MM (FTR) TNW \$500,000 or TA \$5MM (Others)			TNW Must Be > \$0 and TNW \$5MM or TA \$10MM (ALL)			TNW Must Be > \$0 and TNW \$1MM or TA \$10MM (ALL) w/TNW adjustment \$200,000 per/yr. for 5 yrs.			TNW Must Be > \$0 and TNW \$2MM or TA \$10MM (FTR) TNW \$1MM or TA \$5MM (Others) with Annual CPI Adjustment			FTR and Virtuals – Status Quo All others: TNW > max(500k, 2* highest weekly bill) or TA > max(5MM, 10* highest weekly bill)		
		Alternative Security – FTR \$1MM Other – \$500K			Alternative Security All – \$5MM – TNW			Alternative Security – All – \$1MM			Alternative Security – FTR \$2MM – TNW Other – \$1MM-TN			Alternative Security – FTR 1MM Other - \$500K		
Total	Doesn't Meet		Collateral Required (000s)	Doesn't meet		Collateral Required (000s)	Doesn't Meet # Doesn't Meet %		Collateral Required (000s)	Doesn't Meet # Doesn't Meet %		Collateral Required (000s)	Doesn't Meet # Doesn't Meet %		Collateral Required (000s)	
		#	%		#	%		#	%		#	%		#	%	
Generation Owner/ Transmission Owner	359	12	2%	\$6,500	47	6%	\$223,628	43	5%	\$43,000	43	5%	\$47,430	44	5%	\$25,500
Load Serving Entity	103	8	1%	\$4,500	45	6%	\$206,571	36	5%	\$36,000	36	5%	\$38,821	35	4%	\$19,500
Curtailement Service Provider	25	6	1%	\$3,000	18	2%	\$78,424	14	2%	\$14,000	14	2%	\$11,734	12	2%	\$6,000
Financial Trader	129	10	1%	\$7,000	42	5%	\$135,739	13	2%	\$13,000	17	2%	\$20,059	12	2%	\$8,500
Power Marketer	134	4	1%	\$2,500	28	3%	\$116,300	17	2%	\$17,000	18	2%	\$19,364	20	3%	\$11,500
Other	48	0	0	\$0	6	1%	\$27,481	5	0%	\$5,000	5	1%	\$8,068	4	1%	\$4,000
Total	798	40	5%	\$23,500	186	23%	\$788,143	128	16%	\$128,000	133	17%	\$145,476	127	16%	\$75,000

**Package 4** – provides a transition period to grow balance sheet, minimize market disruption and minimal financial impact to participants **Package 5** – two-tier approach with yearly inflation adjustment **Package 6** – status quos for FTR/Virtual players, impacts all participants (large or small), no incentive to grow their b/s



# ISOs/RTOs Minimum Capitalization Comparison

RTO/ISO	Participant Type	Tangible Net Worth (TNW)	Tangible Assets (TA)
<b>PJM</b>	FTR	>\$1M	>\$10M
	Others	>\$500k	>\$5M
<b>SPP</b>	FTR	>\$10M	>\$20M
	Others	>\$1M	>\$10M
<b>MISO</b>	FTR	>\$1M	>\$10M
	Others	>\$500K	>\$5M
<b>CAISO</b>	All Market Participants	>\$1M	>\$10M
<b>ERCOT</b>	FTR	>\$1M	≥\$10M
	Others	>\$500k	>\$5M
<b>ISO-NE</b>	All Market Participants	>\$1M	>\$10M
<b>NYISO</b>	All Market Participants	>\$1M	>\$10M

Per Tariff, Attachment Section III, before participants are eligible to transact in the PJM Markets and as a condition to continued eligibility to transact in the PJM markets, participants must demonstrate they meet:

## 1 Market Participant Eligibility Requirements –

**met through** submission of an Annual Officer Certification Form – demonstrating they can meet the definition of “appropriate person,” “eligible contract participant,” or an entity that generates, transmits or distributes electric energy, to ensure minimum criteria are in place

## 2 Risk Management and Verification –

**met through** the submission of current written risk policies and procedures

## 3 Minimum Capitalization Requirements – Participants must meet certain financial thresholds or provide alternative forms of security to demonstrate their ability to fulfill financial obligations.

- **Tangible Net Worth:** Maintaining a minimum tangible net worth greater than \$1 million for FTRs and greater than \$500K for all other Market Participants
- **Tangible Assets:** Having greater than \$10 million in tangible assets for FTRs and greater than \$5 million in tangible assets for all other Market Participants
- **Alternative Security:** If a participant doesn't meet the tangible asset or tangible net worth requirements, they can post a letter of credit, cash deposit, surety bond or parental guaranty from a guarantor that meets the above min cap thresholds. Such security is restricted collateral and may not be used to support market activity.