Before the Federal Energy Regulatory Commission

Statement of Nigeria Blochynski, Chief Risk Officer

RTO/ISO Credit Principles and Practices Technical Conference
Docket Nos. AD21-6-000; AD-20-6-000

Panel 2: RTO/ISO Comparison of Risk Management Structure, Credit Enhancements and Lessons Learned
Panel 3: Internal Resources and Expertise Within RTOs/ISOs

Feb. 25, 2021
On behalf of PJM Interconnection, L.L.C. ("PJM"), it is a pleasure to participate on these panels and share PJM’s perspective on issues relating to regional transmission organization ("RTO") and independent system operator ("ISO") credit principles and practices, including recent reforms that PJM implemented as part of its comprehensive overhaul of its credit risk mitigation policy and procedures.

My name is Nigeria Bloczynski. I currently serve as the Chief Risk Officer for PJM. I joined PJM in July 2019 as its first Chief Risk Officer. Prior to my employment at PJM, I worked as the head of Commodity & Corporate Risk Management at AltaGas, formerly WGL, a diversified energy business that provides natural gas, electricity, green power, carbon reduction and energy services, from August 2008 to July 2019. I also served as a member of the Board of Directors of the Committee of Chief Risk Officers from November 2016 to October 2020. Prior to joining WGL, I served in compliance and risk management roles at various regulated energy markets and financial services institutions between 1998 and 2008.

As part of my work at PJM, I am responsible for overseeing the enterprise risk management practices across all markets within PJM, including assessing the market and credit risk applicable in PJM’s energy, ancillary services, capacity and Financial Transmission Rights ("FTR") markets.

PJM looks forward to working with the Federal Energy Regulatory Commission ("Commission"), its fellow RTOs and ISOs, its Members and other stakeholders to address these important issues that impact market and credit risk. We appreciate the opportunity to share what we have learned and to learn from others about possible improvements we can make to our respective RTO and ISO risk management policies and procedures to alleviate risk to our markets and Market Participants.

Below is a high-level discussion of several issues that are raised in the Commission’s Notice of Technical Conference, including:

- The structure of PJM’s risk management function
- Key reforms PJM has undertaken to improve its risk management function
- Market design issues
- Communication of information between RTOs, ISOs and our federal regulators
- RTO/ISO discretion in addressing risk and credit risk expertise

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All capitalized terms that are not otherwise defined herein shall have the same meaning as they are defined in the PJM Open Access Transmission Tariff ("Tariff"), Amended and Restated Operating Agreement of PJM Interconnection, L.L.C. ("Operating Agreement"), or the Reliability Assurance Agreement Among Load Serving Entities in the PJM Region.
1. **Structure of the Risk Management Function Within PJM**

Within PJM, the risk management function is broken into five areas: Credit Risk Management, Trade Risk & Analytics, Trade Surveillance, Enterprise Risk Management and Corporate Insurance. The Credit Risk Management team is focused on credit and collateral analysis. We currently use an in-house built system for collateral management. In addition, this team utilizes several credit risk models, data from external credit rating agencies and ongoing “Know Your Customer” analyses. To create more efficiencies, we are automating a number of manual processes through the implementation of an off-the-shelf system. The Credit Risk Management team works closely with other groups within the risk management function, such as the Trade Risk & Analytics team, whose purpose is to measure, quantify and predict risk related to PJM Markets (e.g., weather outlook and impact on collateral, review of risk policies, etc.) and the Trade Surveillance team, whose purpose is to help prevent market abuse and manipulation by monitoring activity across markets.\(^2\)

To evaluate new Market Participants’ risk of default, we look at several factors working in conjunction with the member services function within PJM. We perform “Know Your Customer” due diligence using recognized databases including those of Thomson Reuters Corporation, CLEAR and Westlaw. Key inputs into our process include information we have obtained from the Market Participant which we then validate. For new Market Participants, we also gather information as to which markets they plan to participate in and their reasons for participating in those markets. We do the same for existing Market Participants, in addition to taking into account existing open positions across the PJM Markets.

Upon assessing that there may be increased risk to the PJM stakeholders from a particular Market Participant’s position in the market, we proactively gather additional information. The scope of our inquiry is influenced by the nature of the increased risk. In order to undertake due diligence, we may look to validate data/positions held outside of PJM or validate that we have the most updated information related to the formation of a company and new officers. If we deem the risk to be increasing, we may take additional actions such as asking for Collateral or making demand drawdowns on a letter of credit. In short, we are reaching out on multiple occasions and working to either gain insight or to provide communication on actions we might consider taking, within the Tariff, to address any increased risk.

**Key Reforms PJM Has Instituted**

With Commission and stakeholder support, PJM has undertaken a series of reforms designed to enhance our increased risk management practices. One of our first major reforms included clarification by PJM back in 2009 as to its counterparty status relative to “pool transactions,” i.e., transactions that are direct sales or purchases in or out of the PJM Markets. More recently, in 2020 we substantially revamped our credit policy to incorporate best practices across the PJM Markets.

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\(^2\) The Trade Surveillance team’s work is designed to complement the monitoring functions performed by PJM’s Independent Market Monitor.
A sample list of these past reforms include:

a. **Reduction of Credit Risk Exposure for Bilateral Transactions in Energy Markets** – Effective Feb. 1, 2009 (Docket No. ER09-368-000) – Revised credit risk management rules to reduce credit risk exposure to PJM Members regarding “non-pool” bilateral transactions in the PJM energy markets. These Tariff and Operating Agreement revisions made clear that the members of the “pool” are not responsible for defaults when two Market Participants engage in a bilateral transaction for the purchase and sale of physical energy. Our filing also made clear that the parties to the bilateral transaction must make their own credit arrangements.

b. **Reduction of Credit Risk Exposure for Bilateral Transactions in FTR, Auction Revenue Rights (“ARR”), Ancillary Service and Capacity Markets** – Effective June 1, 2010 (Docket No. ER10-1003-000) – Revised the Tariff and Operating Agreement to further clarify counterparty issues as they relate to bilateral energy transactions in other markets, including PJM’s FTR, ARR, capacity and ancillary services markets.

c. **Creation of PJM Settlement, Inc. as Counterparty** – Effective Jan. 1, 2011 (Docket Nos. ER10-1196-000, ER11-1987, ER11-1988) – PJM Settlement, Inc. was established to be the counterparty to Market Participants and customers with respect to: (a) transmission services; (b) ancillary services transactions; (c) purchases and sales in PJM’s energy markets; (d) purchases and sales of capacity in the Reliability Pricing Model (“RPM”) auctions; and (e) purchases and sales of FTRs in auctions. The counterparty clarification established mutuality between Market Participants and a specified counterparty to best ensure the enforceability of netting and set-off of a Market Participant's debits and credits in a default situation or bankruptcy, thereby reducing the risk of exposure of Members to defaults.

d. **Incorporation of RTEP Upgrades Credit Requirements** – Effective Feb. 9, 2018 (Docket No. ER18-425-000) – Revised FTR credit requirements in Tariff, Attachment Q, to limit potential credit exposure from the projected decreased value of certain FTRs when congestion levels are anticipated to change after a major future transmission upgrade is completed.

e. **Volumetric Minimum FTR Credit Requirement** – Effective Sept. 3, 2018 (Docket No. ER18-2090) – Revised Tariff, Attachment Q to limit potential credit exposure of PJM Members with FTR portfolios, i.e., FTR Holders that have little to no credit requirement relative to the megawatt hour (“MWh”) volume of positions in their FTR portfolios.

f. **Mark-to-Auction Valuation** – Effective April 4, 2019 (Docket No. ER19-945) – The proposed revisions allowed for PJM to make a Collateral Call if a Member’s FTR portfolio is declining in value based on the most recent FTR auction prices, including FTR auction prices provisionally calculated in the process of clearing an open FTR auction. The mark-to-auction valuation – similar to that utilized in commodity and financial markets – is intended to measure FTR market value changes, in particular the difference between the purchase price and the most recent market price, since market value decline can be an indicator of increasing risk to an FTR portfolio.

g. **Comprehensive Overhaul of Credit Risk Mitigation Policy** – Effective June 1, 2020 (Docket No. ER20-1451) – Implemented a comprehensive overhaul of credit risk mitigation policy and procedures with a focus on establishing updated credit risk evaluation and minimum participation requirements for Market Participants in PJM, including establishing or revising: (a) criteria PJM will use to evaluate Market Participant and Guarantor risk for participation in all of the PJM Markets; (b) the types of documents and other information Applicants, Market Participants, and Guarantors must submit for review in the credit evaluation process; (c) PJM’s ability to request additional Collateral and/or restrict the use of Collateral posted by Applicants and Guarantors.
Market Participants; (d) provisions for demonstrating minimum capitalization requirements and other measures of creditworthiness; (e) PJM’s authority to limit, suspend or terminate Market Participants that represent unreasonable credit risk to PJM Markets or fail to meet PJM’s minimum participation requirements; and (f) definitions necessary to implement the above changes.

h. **FTR Portfolio Default Disposition** – Effective Feb. 1, 2021 (Docket No. ER21-520) – Revised Tariff and Operating Agreement to give PJM flexibility in formulating and implementing a plan to appropriately address a defaulting Member’s FTR positions.

i. **FTR Undiversified Adder** – Effective April 26, 2011 (Docket No. ER11-2492) – Revised Tariff to provide an adjustment to the determination of FTR portfolio diversification and associated calculation of the appropriate FTR credit required by a load serving Participant who holds undiversified (i.e., counterflow) FTRs that sink at its load location.

j. **Virtual Bids** – Effective Aug. 8, 2012 (Docket No. ER12-1988) – Revised Tariff and Operating Agreement to modify PJM’s credit standards for “virtual bidding” in PJM’s Day-ahead Energy Market so as to require mandatory Virtual Bid Credit Screening for all Market Participants’ virtual bids and offers. The filing also modified then-existing rules to address the potential for additional credit risk.

k. **Calculation of UTC/Virtual Transaction Credit** – Effective Sept. 1, 2013 (Docket Nos. ER14-69, ER13-1655) – Revised Tariff, Attachment Q to modify PJM’s credit standards related to Virtual Transactions in PJM’s Day-ahead Energy Market to include mandatory bid credit screening for all Market Participants’ Up-to-Congestion Transactions.

l. **Credit Available for Virtual Transactions** – Effective Aug. 25, 2014 (Docket No. ER14-2254) – Revised Tariff to more accurately and clearly reflect PJM’s longstanding methodology for calculating Credit Available for Virtual Transaction.

m. **CFTC Exemption** – Effective Aug. 12, 2013 (Docket No. ER13-1659) – Revised Tariff, Attachment Q to incorporate changes to PJM’s governing agreements to allow it and its Market Participants to qualify for an exemption of specified market transactions from the provisions of the Commodity Exchange Act and Commodity Futures Trading Commission (“CFTC”) regulations, and clarifying revisions concerning PJM Settlement’s ability to enforce and pursue collection efforts against PJM Members in default.

2. **Market Design Issues**

Financial markets have a different risk profile from physical markets, as do forward contracts. As an example, with reference to the PJM FTR market, increasing the frequency of FTR auctions or any other non-daily traded transaction type is a benefit and provides Market Participants with further price insight to help estimate potential exposure. By the same token, Market Participants may be transacting in a particular market or trading hub to hedge the position of a physical asset or load position in the market, or they may be looking for arbitrage opportunities. The level of analysis and credit risk must understand the Market Participant’s role in the market.

In short, although market design can affect credit risk, the more central focus needs to be on developing and implementing a strong credit policy. A strong credit policy can help manage risk directly. Market design should not prove a substitute or alternative to ensuring strong, fair and effective credit risk policies.
3. Communication Among RTOs/ISOs and Relevant Federal Agencies

We communicate regularly with our RTO/ISO colleagues in order to share best practices and approaches. However, provisions in our respective tariffs and other governing documents limit our ability to share Member-specific information with our counterparts, even if the Member is doing business in multiple RTOs/ISOs and may pose a credit risk in multiple markets. The PJM Operating Agreement, for example, limits discussion of market-sensitive confidential information to strictly within PJM (and by extension to PJM’s Independent Market Monitor). Although these confidentiality provisions are critical to ensure Market Participants that the information they share with PJM will be held in confidence, to the extent there are “red flags” that PJM discovers as part of its due diligence, our ability to communicate those to our RTO/ISO brethren on a Market Participant basis is quite limited.

This is an issue that will need further discussion with our stakeholders but would also benefit from Commission guidance as well. For effective communication to occur among RTOs/ISOs facing credit risk from a single Market Participant operating in one another’s markets, barriers to such communication would need to be addressed across multiple RTOs and ISOs. For this reason, no one RTO/ISO can singularly address this issue. Nevertheless, we do recognize the need to both ensure strict confidentiality and balance the need to protect the Market Participant’s market-sensitive information with our obligation to address any increased credit risk occurring from a Market Participant’s position in multiple RTO/ISO markets.

By the same token, although the Commission and CFTC have to balance the need to conduct confidential investigations with their own responsibilities to ensure transparency, PJM believes this is an area that could benefit from further dialogue. Specifically, to the extent an investigation target is still conducting business within an RTO/ISO market, appropriate safeguards can be put in place — such as requesting additional collateral while still respecting the ability of the Market Participant to do business while a possibly lengthy investigation proceeds. Having transparency to such information is part of an RTO/ISO’s “Know Your Customer” evaluation and can be crucial in making effective risk management decisions.

4. RTO/ISO Discretion Issues

If the RTO/ISO is responsible for addressing risk in its wholesale markets, then it should have a certain level of discretion to do so.

With the Commission’s support, PJM incorporated new rules giving the RTO/ISO the ability to make unreasonable credit risk determinations that are not cabined by an overly prescriptive Tariff. Rather, PJM has been afforded the reasonable discretion to evaluate individual facts and circumstances, as necessary, to protect the PJM-administered markets without limiting PJM to act only in specific scenarios of increased credit risk enumerated in the Tariff. Indeed, it would be imprudent and unreasonable to “cookie cutter” the Tariff in a manner which would prevent PJM from either requiring Collateral, or even rejecting an application entirely, if an Applicant posed an unreasonable credit risk.
We support the transparency and accountability that our Tariff provides and the Commission’s role in ultimately adjudicating disputes. However, the responsibility of a market gatekeeper is to close the gate if it identifies what it determines is an unreasonable credit risk. In Order No. 741, the Commission held that an RTO/ISO’s credit policy “should allow the ISOs and RTOs to use their discretion to request additional collateral in response to unusual or unforeseen circumstances.” While the Commission made that statement in the context of Material Adverse Changes, the same conclusion holds for a determination of unreasonable credit risk. After all, both contexts seek to achieve the same goal: protect the PJM Markets and PJM Members from a Market Participant’s default. We are appreciative that the Commission has recognized that providing a certain level of discretion to the RTO/ISO in assessing credit risk appropriately strikes a balance between providing sufficient flexibility to an RTO/ISO to protect the wholesale markets, while providing certainty and transparency to the affected Market Participant.

To improve transparency and predictability, PJM did incorporate key parameters around its exercise of discretion when addressing credit risk. Specifically, PJM has identified certain explicit indicators of potentially unreasonable credit risk. Specific data points that PJM will analyze as part of its credit risk policies include:

- Does the Market Participant have a history of market manipulation based upon a final adjudication of regulatory or legal proceedings?
- Does the Market Participant have a history of financial defaults, bankruptcy or insolvency within the past five (5) years, or a combination of current market and financial risk factors such as low capitalization?
- Is it reasonably likely that the Market Participant will incur a future material financial liability?
- Does the Market Participant have a low Internal Credit Score (discussed below), and/or a low externally derived credit score?

In PJM, each entity’s risk profile is inherently individual and fact-dependent. The Market Participant’s risk profile includes such factors as the entity’s purpose for participating in the PJM Markets (e.g., is its main function to hedge commercial risks arising from its ongoing operations, or is its business model solely focused on transacting or trading for financial gain/profit?).

Given that PJM today has over a thousand Members participating in the PJM Markets with vastly different business models, PJM has crafted the Tariff provisions (and received Member support for the same) in a manner which avoids a “one size fits all” approach to establishing or quantifying an unreasonable credit risk determination. Indeed, none of the factors listed above is dispositive. Rather, all the relevant facts will be weighed, and a decision will be made based on the totality of the circumstances for each individual entity at a particular time, since different entities will pose different risks at different points in time depending on, for example, the size of a company or scope of its participation and positions in the PJM Markets, the membership Sector of the company and its history of market participation.

Through its newly revised credit risk mitigation rules, PJM is now better able to gather significantly more information (and more current information) regarding the credit risk an entity may pose to the PJM Markets. Further, the new rules provide a greater structure for obtaining and processing such information on an initial and ongoing basis. Such information will allow for informed and reasonable discretion in managing credit risks to the PJM Markets.
5. **Internal Resources and Expertise Within RTOs/ISOs**

The basic principles of risk management involve the ongoing identification, analysis, control, response, monitoring and reporting of risk. This should be a continuous process, and not solely dependent on assessing historical financial statements. As far as governance goes, I believe that each division and each person within an RTO/ISO has some responsibility for risk management. Having a good framework in place provides the foundation for making risk-based decisions.

When building the PJM risk department, the skill sets that I believe are essential are:

a. An understanding of commodity trading and how physical and financial markets operate
b. Experience with risk assessment
c. An understanding of emerging changes facing electricity markets
d. An understanding of how market drivers or changes in regulations or policies may impact credit exposure
e. An understanding of the underlying strategy of the companies that are participating in the market
f. Effective communication skills
g. A nimble and proactive mindset and approach to assessing risk
h. An understanding of the fundamental concepts of economic, financial and/or mathematical theories and their applications in electricity markets

Additionally, one needs to understand the links between market and credit risks and how market events, like price volatility or a pandemic, can have an impact on the ability of an entity to continue its operations and/or remain a viable business for the foreseeable future. We should encourage people to ask questions, challenge the current assumptions, look for opportunities to create efficiencies, and be aware of upcoming regulatory or market changes and how they could impact on our processes.

I believe that opportunities for training and development should be available on a continual basis, whether through formal training or informal networks. We have utilized such training and development courses for our staff on a regular basis.

Having thorough internal processes and effective management information systems allows for the awareness of the speed and severity of changes in the underlying variables driving risk. Some of these variables that affect risk include weather impacts, the effect of a planned/unplanned outage, or price volatility in another market. Testing the effectiveness of the systems/models/tools should include but not be limited to stress testing, sensitivity analyses and different scenario analyses.
In order for an RTO/ISO to effectively manage risk, there should not be a limit as to how often the risk department communicates with other departments within the RTO/ISO. Cross-departmental communication should be organic and “baked into” the culture of the organization. For example, I encourage my team to reach out to other parts of the organization to make sure we have an understanding of how a change we may be thinking of implementing will impact other RTO/ISO areas of responsibility, be they in markets, planning or IT. Another example of reaching out are the RTO/ISO committees of the ISO/RTO Council. We have utilized the Council’s committee structure to allow risk professionals in multiple RTOs/ISOs to exchange ideas and incorporate best practices.

In summary, I am a firm believer that RTOs/ISOs should be able to share information on issues they are confronting, especially with regard to certain Market Participants. We need transparency, not only within the RTO/ISO community to help mitigate risk, but in the broader commodity space as well. With the varied groups of participants in our markets, we need to understand how they are engaging, and we need the ability to validate what they are telling us. Transparency is key to understanding and eventually mitigating large risk exposures.

Thank you for the opportunity to submit these comments.