Surety Bonds

Markets & Reliability Committee
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Proposed Solutions

The Market Implementation Committee endorsed two packages:

- Package A (61% Support): Accepting Surety Bonds as collateral for all market purposes, except FTRs, with a $10 million cap per issuer for each member, and a $50 million aggregate cap per issuer.

- Package B (58% Support): Accepting Surety Bonds as collateral for all market purposes, including FTRs, with a $20 million cap per issuer for each member, and a $100 million aggregate cap per issuer.

PJM's Position

PJM learned from our research that there is limited experience in the use of surety bonds in the FTR markets and historically, FTR defaults have been large.

PJM will support Package A - Accepting Surety Bonds as collateral, using a form of surety bond acceptable to PJM, for most products in the PJM Markets, <u>excluding FTRs</u>, with a $10 million cap per issuer for each member, and a $50 million aggregate cap per issuer.

Next Steps

The June 2020 Members Committee will seek endorsement on the favored package.

APPENDIX

Problem Statement Summary and History

January 2018: Exelon presented Problem Statement & Issue Charge requesting consideration of surety bonds as a form of collateral.

September 2018: Credit Subcommittee polled two stakeholder proposals and presented results to the Market Implementation Committee (MIC)

October 2018: The Market Implementation Committee endorsed the two packages with 61% in support of Package A.

December 2018: PJM presented the two packages to the Markets & Reliability Committee (MRC) and the committee approved a motion to defer voting on these packages until the first MRC meeting following issuance of the report of the consultants retained by the PJM Board of Managers to review the GreenHat Energy default.

April 2019: At the MRC meeting, stakeholders voted in favor of deferring a vote on the surety bond package until no later than two MRC meetings after the new PJM Chief Risk Officer and Chief Financial Officer began working at PJM.

At that meeting, PJM agreed to provide a recommendation to the MRC as to the efficacy of the proposed surety bonds.

Market Participants: Advantages/Disadvantages

Advantages for Market Participants

- Bond can be less expensive than letters of credit but is dependent upon the credit and risk profile of the market participant.
- Surety bonds do not tie up PJM Member's letter of credit facility.

Disadvantages for Market Participants

- Market Partcipant would have to meet Surety companies' underwriting standards for them to issue bonds which may be more costly.
- An impact of the Coronavirus pandemic is that sureties may become weaker and develop a loss of appetite for these types of bonds.
- Sureties would have to be willing to comply with PJM's bond form and the bond company AM Best rating requirements

Advantages for PJM

- The credit quality of the surety providers is on par with the banks that typically post letters of credit to PJM.
- The surety industry has a reliable claims paying history. Like the banking industry, sureties work in a heavily regulated market with strong government oversight.
- More flexibility for PJM members to meet PJM collateral requirements.

Disadvantages for PJM

- There is very little experience drawing on these instruments to pay ISO/RTO market participant bills.

Requirements for surety bond acceptance, if approved:

- Surety Bond Company must be listed on the Department of U.S Treasury’s certified list .
- Minimum credit rating of “A” with S&P; “A” with Fitch, “A2 “with Moody’s or “A” with AM Best.
- Must be licensed in the state the bond is issued.
- Accept One Day Payment Demand Terms
- Automatic Annual Renewal Provision