

Credit Factors

Capacity Senior Task Force
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- Credit determinants
 - Type of exposure
 - Source
 - Magnitude
 - Timing
 - Uncertainty
 - Creditworthiness
 - Of obligated party

- **Credit determinants**
 - **Type of exposure**
 - Financial (energy)
 - Reliability (RPM)
 - May influence purpose and therefore design of credit requirements
 - **Source**
 - The event or structure that causes the obligation/exposure
 - **Magnitude**
 - Size of position
 - MW or MWH
 - Dollars

- Credit determinants

- Timing

- Point at which exposure is created
 - What is the point of no return
 - Must get credit before this point or there is no guarantee that it can be obtained later

- Delay

- Time before impact is felt
 - » Not the same as point of exposure - Impact may not be felt until long after exposure point
 - Multiple years before start of planning year
 - Depending on situation, exposure may increase over time
 - Duration - length of time position is exposed
 - One or more planning years

- Credit determinants
 - Uncertainty
 - Uncertainty in magnitude
 - Single events or highly correlated events are often collateralized at the high end (e.g. 97 percentile) of possibilities
 - » Reducing uncertainty can dramatically reduce these normal credit requirements
 - Multiple events with low correlation are often collateralized at a lower level
 - Likelihood of exposure occurring
 - Existing capacity resources
 - » Historically deemed “low likelihood of non-performance” due to nominal forward operating cost vs. initial cost
 - Planned capacity resources
 - » Historically deemed more uncertain than existing due to high initial cost and uncertainties in development
 - » Depending on market design, may include financial players (speculators) that play the spread between auctions

- Credit determinants
 - Creditworthiness
 - Who is the obligated party
 - How financially strong is the party
 - What incentives does the party have to perform/walk away
 - Is there any other “skin in the game”
 - Could the party walk away if it wanted
 - Regulatory issues
 - Structural (e.g. ratepayers)
 - A financial commitment borne by PJM Loads (e.g. RPM capacity charges) is much less likely to create a default exposure than a financial commitment borne by a single company

- Example – existing RPM auction credit
 - Type
 - Reliability – commitment to be a capacity resource for the planning year
 - Financial component is the penalty rate, but if that is not paid, no member is financially short, but rather short on reliability
 - Design – influenced by type
 - Financially set equal to penalty rate
 - Timing
 - Impact point is start of planning year
 - Exposure point is when offers are cleared in the auction

- Example – long-term capacity auction folding into RPM auction with no load commitment
 - Type
 - Financial (reliability is addressed in the BRA)
 - Timing
 - Exposure point is when original auction is cleared
 - But magnitude is unknown
 - Intermediate exposure/impact point when RPM BRA clears
 - Establishes magnitude of exposure
 - Impact point is start of planning year