

Statement of Approach: How Internal Compliance Programs (ICPs) are Considered by MACD

Background Material for Informational Webinars
November 2013



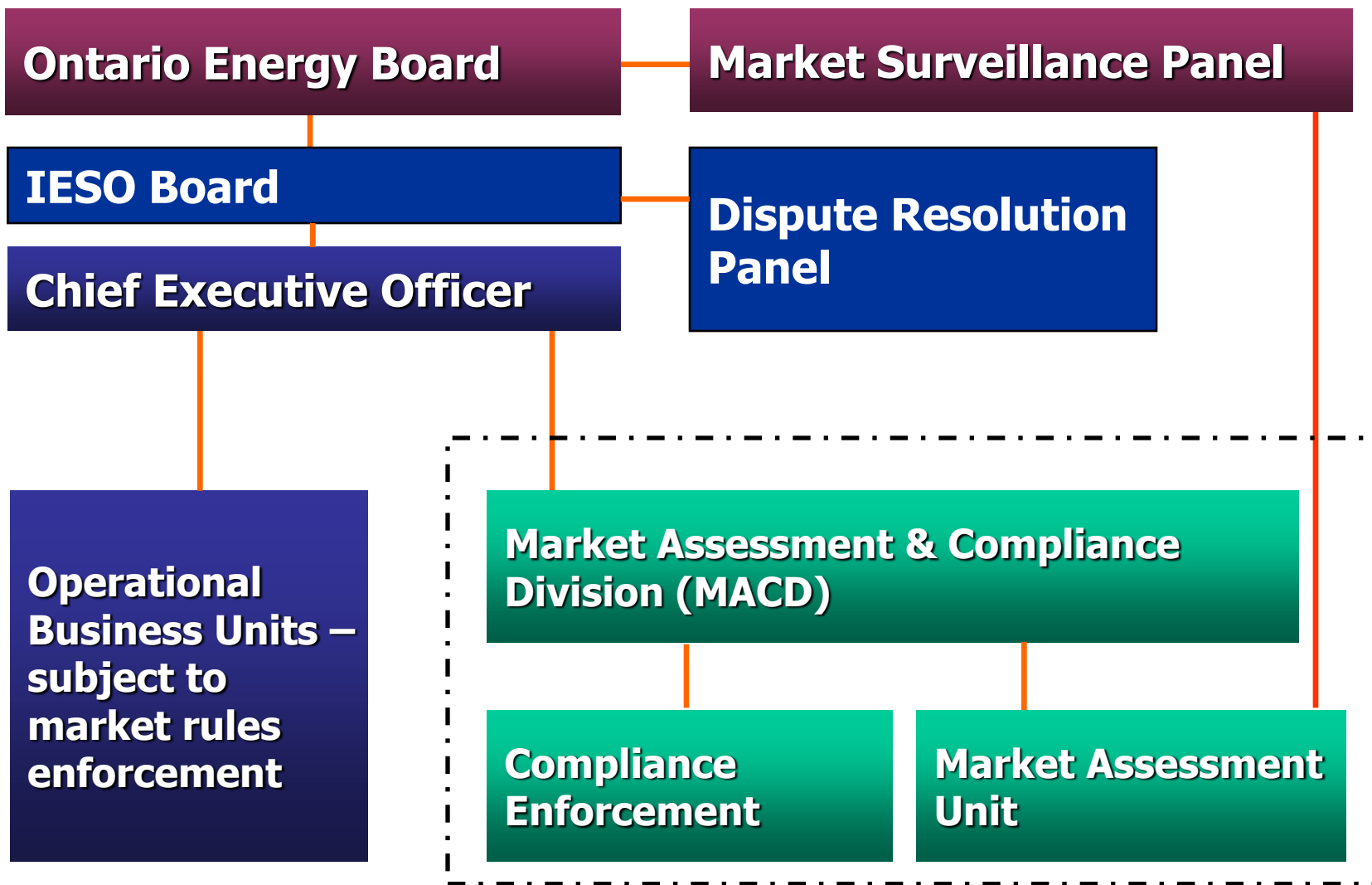
- Background on MACD
 - IESO's mandate
 - MACD's structure and authorities
 - MACD's enforcement processes
- Background About This Initiative
 - Key drivers, context, expected outcomes
 - Rights and obligations – MACD and MPs
- Overview of ICPs
 - Definition of an internal compliance program (ICP)
 - Scope and components of an ICP
 - MACD and the industry
- Additional Resources for Market Participants

Background on MACD

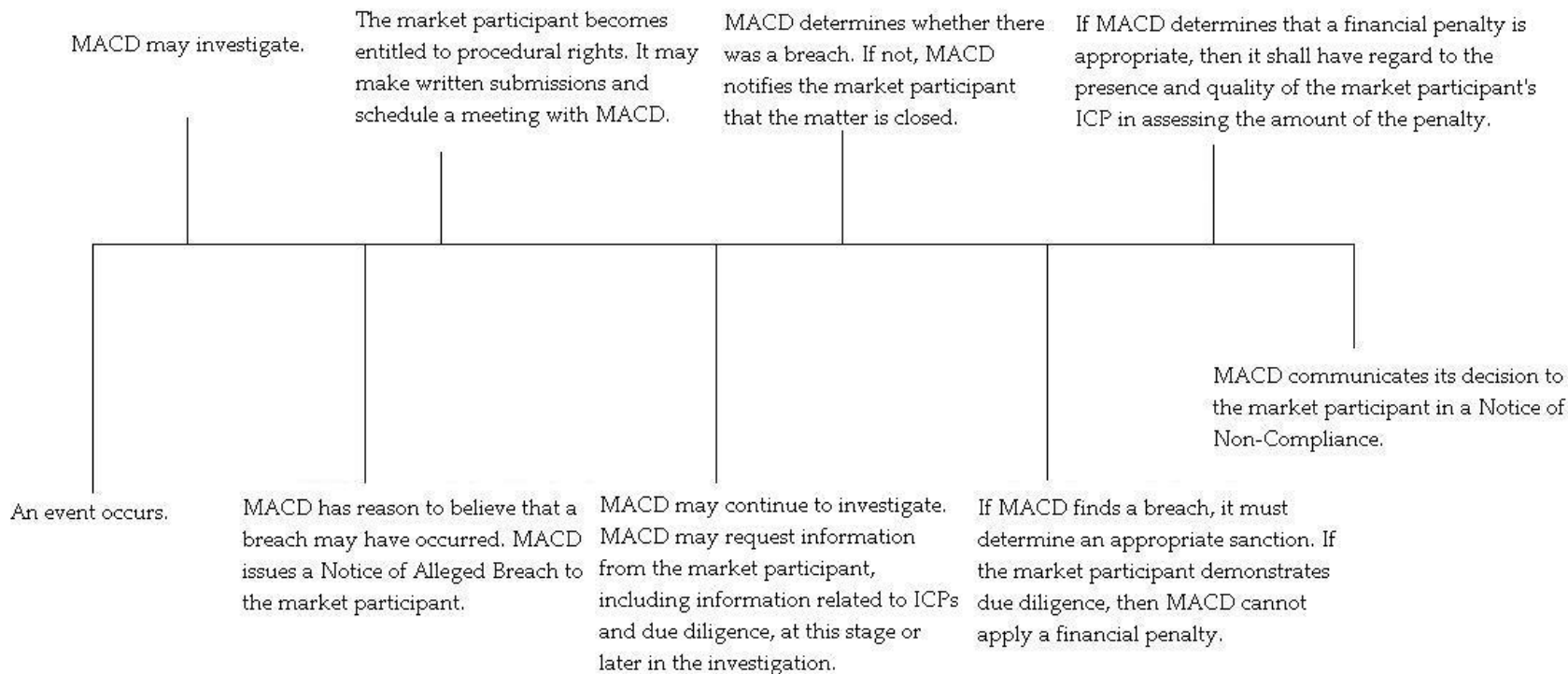
- Objects and Mandate of the IESO under the *Electricity Act, 1998* include:
 - To direct the operation and maintain the reliability of the IESO-controlled grid to promote the purposes of this Act; and
 - To operate the IESO-administered markets to promote the purposes of this Act
- Purposes of the *Electricity Act, 1998* that relate to MACD's mandate include:
 - To promote economic efficiency;
 - To ensure the adequacy, safety and reliability of electricity supply in Ontario; and
 - To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.

- Letter of Delegation from the IESO's President and CEO to the Director of MACD provides clarity on the relationship:
 - Confirms delegation of certain powers and duties assigned to the IESO in the market rules;
 - Allows MACD to make all determinations and exercise all authorities related to monitoring, investigating and enforcing market rules; and
 - Reiterates that the IESO has voluntarily agreed to be treated as if it were a market participant regarding delegated enforcement powers and duties.

- Chapter 1, section 5.3.1.1 of the Market Rules outlines the IESO's functions, powers and authorities with respect to the administration and supervision of the market rules
- They include:
 - Supervising, administering and enforcing the market rules
 - Instituting and ensuring through...enforcement of the market rules the effective and efficient implementation of the rules and standards contained in the market rules
 - Undertaking monitoring, surveillance and investigations of activities in the IESO-administered markets and the conduct of market participants



Investigative Activities and Events: ICP Considerations



Investigative activities and events may overlap and are not necessarily in sequence

Investigation

- An event occurs that comes to MACD's attention
- MACD may investigate the event
- As the investigation progresses, the market participant will be entitled to notice and other participatory rights
- The investigation may rely on the IESO's data and/or involve a request for information from the market participant, which may include information related to or regarding its ICP

Breach Determination

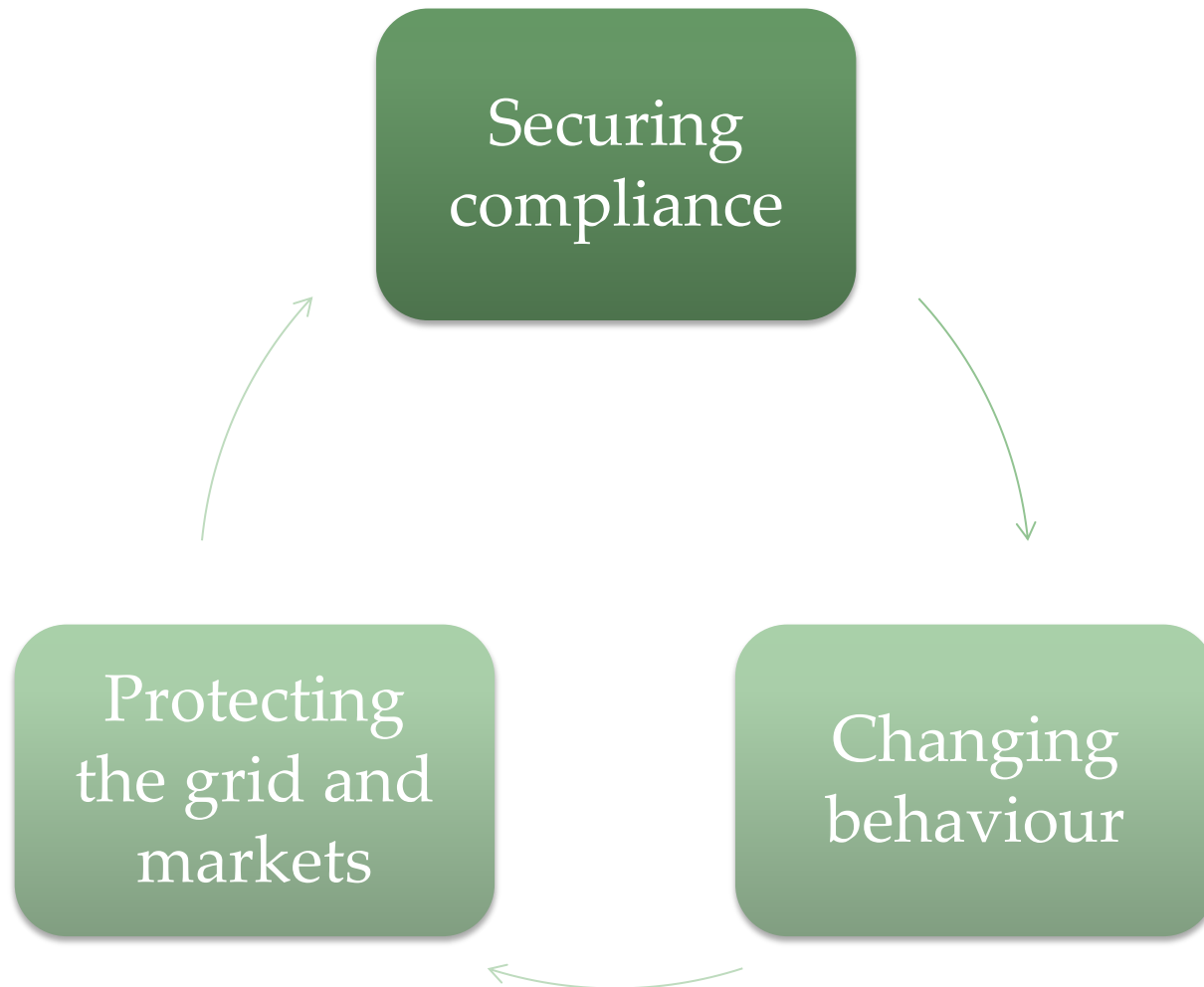
- Based on its investigation, MACD will determine whether there was a market rule breach
- If MACD does not find a breach, it will close the investigation
- If MACD finds a breach, it will then determine an appropriate sanction

Sanction Determination: Due Diligence and Penalty Assessment

- The market rules provide several possible sanctions, including a compliance letter, a compliance order or a financial penalty
- However, MACD can only apply a financial penalty if the market participant failed to exercise due diligence
- On a case-by-case basis, an internal compliance program (ICP) may help the market participant demonstrate due diligence
- When MACD determines that it is appropriate to impose a financial penalty, it is required under Chapter 3, section 6.6.7 and 6.6.7.13 to “have regard to” the “presence and quality of the market participant’s compliance program” as well as other penalty factors in Chapter 3, section 6.6.7 in determining that penalty

Background About This Initiative

IESO Mandate – Expected Outcome



- Where appropriate, MACD's preference is breach prevention not enforcement actions
- Shift in focus to ICP reviews
- MACD's knowledge of ICPs has matured
 - 11 years of enforcement experience in Ontario
 - Relationship with other enforcement bodies (eg. FERC, NERC, Canadian regulators)
 - Research into North American and international regulators inside and outside the electricity sector
 - Industry expert contracted to provide guidance
- ICP reviews increasingly becoming a regular practice in the industry and elsewhere

- Chapter 3, section 6.6.7 and 6.6.7.13 of the market rules requires MACD to “have regard to” the “presence and quality of the market participant’s compliance program” in the event of an enforcement matter that leads to a penalty assessment
- Market participants are not mandated to develop or implement internal compliance programs (ICPs) under the market rules but...
 - There is a requirement for market participants to comply with market rules
 - MACD considers ICPs essential to market rule compliance
 - MACD is promoting the creation and/or improvement of ICPs by publishing its views and perspectives on ICPs in an enforcement context

Overview of ICPs

- An internal compliance program (ICP) is defined as a program that is intended to achieve the outcome of compliance with applicable obligations under the market rules
 - Framework of interdependent components
 - Policies, procedures and practices
 - Management
 - Accountabilities and responsibilities
 - Systems and mechanisms etc.
 - ICP considerations
 - Help to define an ICP further
 - Organization of an ICP according to 8 components
 - Recognition that ICPs are a combination of governing structures, mechanisms and practices

- FERC
 - Defines a compliance program as “a program designed to prevent and detect violations”
 - Approach to considering ICPs is consistent with US Federal Sentencing Guidelines
 - Elements of an ICP embedded within FERC’s 13 questions
- NERC’s Reliability Assurance Initiative (RAI)
 - Emphasis is on the system of internal controls
 - Internal control programs are an intricate part of a designed business process to achieve certain objectives; definition focuses on compliance with Reliability Standards
 - Relates internal control activities that help a Registered Entity achieve compliance with a Reliability Standard
- US Federal Sentencing Guidelines
 - Defines a “compliance and ethics program” as a program designed to prevent and detect criminal conduct
- AS3086-2006 Compliance Programs
 - Defines a compliance program as “a series of activities that when combined are intended to achieve compliance”

- Organized as a set of components relevant to an ICP review by MACD
 1. Compliance Standards and Procedures
 2. Organizational Leadership
 3. Roles and Accountabilities
 4. Compliance Risk Assessment
 5. Training and Compliance Communication
 6. Monitoring Controls and Evaluating Compliance Program Effectiveness
 7. Performance Incentives and Disciplinary Actions
 8. Response to Breaches and Remedial Actions

- Quality ICPs can contribute to grid reliability and market efficiency, which apply to all market participants
- Market participants can also derive other significant benefits from having a comprehensive ICP, including:
 - Reducing the likelihood of inadvertent market rule breaches and providing early warnings of potential market rule breaches through improvements in detection methods;
 - Assisting market participants to identify and assess the compliance risks they face and providing a greater ability to manage and mitigate compliance risks;
 - Increasing awareness of compliance-related obligations and accountabilities amongst employees for demonstrating compliance with the market rules and identifying potential non-compliance on a timely basis;
 - Assisting market participants to deal efficiently with a market rule breach, investigation and other requests for information from MACD and providing evidence of actions taken to achieve compliance through enhanced investigative information quality; and
 - Potentially reduce costs, adverse publicity and disruption to business operations, related to investigations, both internal and external.

- In addition to these compliance-related outcomes, ICPs may also provide broader business benefits, as part of a market participant's corporate governance mandate:
 - Contributing to more informed decision-making about resource allocation amongst compliance and other strategic priorities;
 - Incorporating compliance with regulations into business planning and decision-making processes, leading to more efficient business operations; and
 - Increasing the transparency of compliance-related risks, and corporate risk tolerance associated with non-compliance, relative to other business risks.

- The IESO's mandate is to operate and maintain reliability of the grid and operate efficient markets, which is promoted by market rule compliance
- In your consideration of your organization's risks, we encourage market participants to include compliance with market rules and make business decisions that promote compliance and support the IESO's mandate
- MACD's decisions to pursue breaches or exercise discretion are not altered by a market participant's risk assessment or risk tolerance, as established within its ICP
- MACD recognizes that some breaches of the market rules are less serious than others and has the discretion to not pursue every possible breach of the market rules and to resolve breaches through various means, as deemed appropriate

- Timelines for ICP implementation are specific to each market participant and its strategic priorities and risks
- As a result, MACD will not provide guidance on an appropriate timeline for ICP implementation

- MACD's approach to reviewing ICPs is generally consistent with the industry's approach
 - NERC's 7 factors
 - ICP considerations were modeled on the 7 factors
 - FERC's 13 questions
 - NERC's Reliability Assurance Initiative (RAI)
 - Focus is on the system of internal controls to achieve compliance with reliability standards
 - "Internal controls are a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of reporting, and compliance with applicable laws and regulations"
 - NERC review and test these same control activities to obtain reasonable assurance of compliance
 - NERC also does not describe a mandatory process or approach for the consideration of internal controls
 - Working Guide on Internal Controls facilitates dialogue and is a useful reference document

The following documents are useful in understanding the context and background under which the Statement of Approach has been issued. These documents also provide a more thorough description of MACD's specific responsibilities to enforce compliance, which includes the levying of financial penalties.

Market Rules, Chapter 3, section 6.6.7.13

Market Rules, Chapter 3: Administration, Supervision, Enforcement, MDP_RUL_0002_03

http://www.ieso.ca/imoweb/pubs/marketRules/mr_chapter3.pdf

Market Manual 2.6: Treatment of Compliance Issues

Market Manual 2: Market Administration: Part 2.6: Treatment of Compliance Issues, MDP_PRO_0022

http://www.ieso.ca/imoweb/pubs/marketAdmin/ma_CompIssues.pdf

Market Rules, Chapter 11: Definitions

Market Rules: Chapter 11: Definitions, MDP_RUL_0002_11

http://www.ieso.ca/imoweb/pubs/marketRules/mr_chapter11.pdf

Market Manual 11.2: Ontario Reliability Compliance Program

Market Manual 11: Reliability Compliance Part 11.2: Ontario Reliability Compliance Program, IESO_PRO_0874

http://ieso.ca/imoweb/pubs/ircp/rc_ReliabilityCompProgram.pdf

There are many authoritative resources on risk management, internal control frameworks and process maturity models. Regulators from different jurisdictions also publish guidance about their approaches to considering ICPs for compliance obligations related to various legislative requirements. Some of these reference documents may provide additional information to market participants as they develop and enhance their ICPs. Limited references, some of which helped to shape MACD's views and perspectives on ICPs, include the following:

North American Electric Reliability Corporation

Sanction Guidelines of the North American Electric Reliability Corporation, section 4.3.5

http://www.nerc.com/files/appendix4b_sanctions_guidelines_effective_20080115.pdf

NERC's Reliability Assurance Initiative

The Reliability Assurance Initiative program is a program launched by NERC that promotes internal control programs and activities that help a Registered Entity achieve compliance with a Reliability Standard. Readers may find the guidance complimentary to this Statement.

<http://www.nerc.com/pa/comp/Pages/Reliability-Assurance-Initiative.aspx>

<http://www.nerc.com/pa/comp/Reliability%20Assurance%20Initiative/RAI%20QA%20Document.pdf>

NERC's Internal Controls Working Guide:

<http://www.nerc.com/pa/comp/Reliability%20Assurance%20Initiative/RAI%20Internal%20Controls%20Working%20Guide%20Document.pdf>

Federal Energy Regulatory Commission

FERC Revised Policy Statement on Penalty Guidelines: Section §1B2.1. Effective Compliance Program

Federal Energy Regulatory Commission Docket No. PL10-4-000 Revised Policy Statement on Penalty Guidelines: Issued September 17, 2010)

<http://www.ferc.gov/whats-new/comm-meet/2010/091610/M-1.pdf>

Western Electricity Coordinating Council (WECC)

Internal Compliance Program Assessment (ICPA) questionnaire to help entities assess their internal compliance programs:

http://www.wecc.biz/compliance/United_States/Documents/ICP_Assessment_Document.docx

Competition Bureau (Canada)

Bulletin – Corporate Compliance Programs:

[http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/CorporateCompliancePrograms-sept-2010-e.pdf/\\$FILE/CorporateCompliancePrograms-sept-2010-e.pdf](http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/CorporateCompliancePrograms-sept-2010-e.pdf/$FILE/CorporateCompliancePrograms-sept-2010-e.pdf)

Remarks by the Commissioner of Competition on credible, effective compliance programs:

<http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03629.html>

Office of the Privacy Commissioner of Canada (OPC) and the Offices of the Information and Privacy Commissioners (OIPCs) of Alberta and British Columbia

Getting Accountability Right with a Privacy Management Program:

http://www.priv.gc.ca/information/guide/2012/gl_acc_201204_e.pdf

Committee of Sponsoring Organizations of the Treadway Commission (COSO)

Internal Control - Integrated Framework

<http://www.coso.org/IC.htm>

http://www.coso.org/documents/990025P_Executive_Summary_final_may20_e.pdf

<http://www.coso.org/documents/COSO%20FAQs%20May%202013%20branded.pdf>

Information Systems Audit and Control Association (ISACA)

Control Objectives for Information and Related Technology

<http://www.isaca.org/cobit/pages/default.aspx>

<http://www.isaca.org/cobit/pages/default.aspx>

Open Compliance & Ethics Group (OCEG)

Various resources for integrating the governance, assurance and management of performance, risk, compliance and ethics

<http://www.oceg.org/category/theme/compliance-management/>

Standards Australia

Australian Standard 3086-2006 Compliance Programs

<http://www.saiglobal.com/PDFTemp/Previews/OSH/as/as3000/3800/3806-2006.pdf>

FERC 13 questions:

FERC provided 13 questions representing factors to be taken into account in determining credit, if any, that can be given for the existence of a compliance program when considering enforcement action and penalties.

1. Does the company have an established, formal program for internal compliance?
2. Is it well documented and widely disseminated within the company?
3. Is the program supervised by an officer or other high-ranking official?
4. Does the compliance official report to or have independent access to the chief executive officer and/or the board of directors?
5. Is the program operated and managed so as to be independent?
6. Are there sufficient resources dedicated to the compliance program?
7. Is compliance fully supported by senior management? For example, is senior management actively involved in compliance efforts and do company policies regarding compensation, promotion, and disciplinary action take into account the relevant employees' compliance with Commission regulations and the reporting of any violations?
8. How frequently does the company review and modify the compliance program?
9. How frequently is training provided to all relevant employees?
10. Is the training sufficiently detailed and thorough to instill an understanding of relevant rules and the importance of compliance?
11. In addition to training, does the company have an ongoing process for auditing compliance with Commission regulations?
12. How has the company responded to prior wrongdoing? Did it take disciplinary action against employees involved in violations? When misconduct occurs, is it a repeat of the same offense or misconduct of a different nature?
13. Does the company adopt and ensure enforcement of new and more effective internal controls and procedures to prevent a recurrence of misconduct?

Seven Elements of an Effective Compliance Program

Consistent with FERC's 13 questions, the following seven factors are provided within the Penalty Guidelines:

- The organization shall establish standards and procedures to prevent and detect violations.
- The organization's governing authority, senior management and individuals shall be provided resources and authority, and shall be knowledgeable and accountable.
- Persons with substantial authority shall not have engaged in conduct inconsistent with an effective compliance program.
- The organization shall offer training and compliance communication throughout all levels of the organization.
- The organization shall ensure the compliance program is followed, periodically evaluate the effectiveness of the program, and include a method for safe reporting of potential or actual violations.
- The organization shall promote the program through incentives and disciplinary measures.
- In the event a violation occurs, the organization shall respond, mitigate and prevent future occurrences.