

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

An Information Session for Market Participants

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- Introductions and expectations
- Background to this initiative
- The enforcement context for the Statement of Approach on Internal Compliance Programs (ICPs)
- ICP working group of stakeholders
- The Statement of Approach:
 - How the Statement is organized
 - Value to market participants
 - Market Assessment and Compliance Division's (MACD's) approach to ICP reviews
 - Principles, considerations and attributes
 - Integration with enforcement
- Next steps
 - Timing

- MACD's key objectives:
 - Communicate important information with stakeholders about the Statement of Approach, which outlines how MACD considers internal compliance programs (ICPs)
 - Ensure the Statement of Approach is clear, within its defined scope and purpose
 - Encourage the development of ICPs that are tailored to market participant organizations
 - Publish the Statement of Approach by end of year

- For the purpose of the Statement of Approach, an ICP is defined as “a program that is intended to achieve the outcome of compliance with applicable obligations under the market rules”
- It is a framework of interdependent components that include policies, procedures, management, accountabilities, systems, mechanisms and practices established by market participants to manage compliance with applicable market rules
- Why are we telling you this?
 - MACD may collect information about ICP presence and quality during an investigation or, if a penalty is appropriate, wait until a penalty determination
 - The market rules require MACD to review ICP “presence and quality” during a penalty assessment
 - Any ICP is better than no ICP and generally results in a smaller penalty amount

- 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

- MACD is required under Chapter 3, sections 6.6.7 and 6.6.7.13 to “have regard to” the “presence and quality of the market participant’s compliance program” in the event of a penalty assessment and may request information at any time during an investigation
- Under the market rules, market participants are not mandated to have internal compliance programs (ICPs) but...
 - There is a requirement for market participants to comply with the rules
 - Other regulatory bodies in the electricity sector are encouraging ICP development
 - MACD considers ICPs essential to market rule compliance
 - MACD is promoting the creation and/or improvement of ICPs

- MACD's approach to reviewing ICPs is consistent with the industry's approach
 - NERC and FERC
 - ICP considerations were modeled on the 7 factors and 13 questions
 - NERC's Reliability Assurance Initiative (RAI)
 - Focus is on the system of internal controls to achieve compliance with reliability standards
 - NERC reviews and tests these same control activities to obtain reasonable assurance of compliance
 - NERC does not want to describe a mandatory process or approach for the consideration of internal controls
 - Working Guide on Internal Controls facilitates dialogue and is a reference document

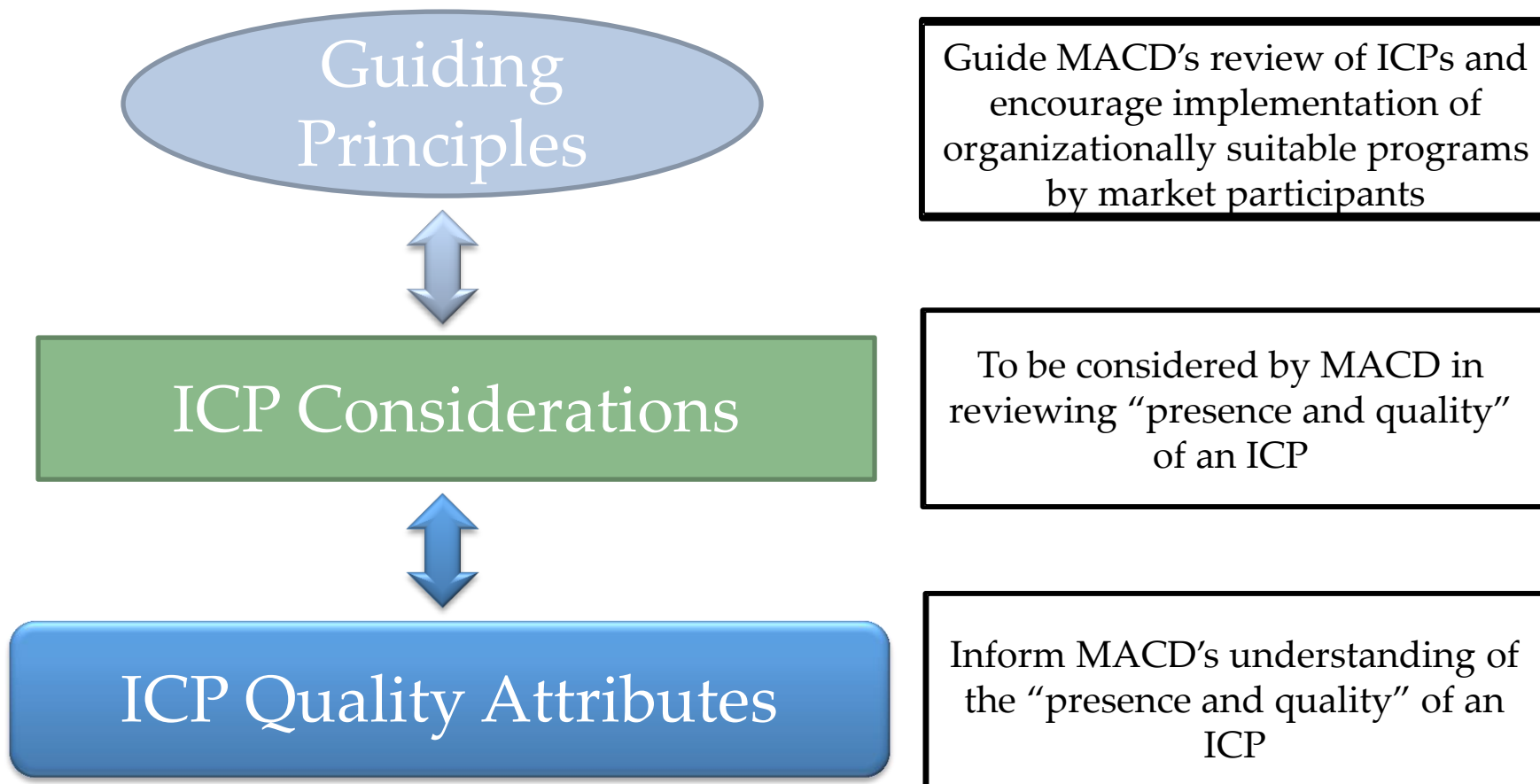
- To ensure the Statement of Approach was clear, MACD struck a stakeholder working group to provide early feedback
 - Members represented a cross-section of the IESO's key stakeholders, including a generator, a renewable generator, a local distribution company (LDC), a transmitter, a trader and a large industrial consumer
 - All members had knowledge of corporate governance, compliance and/or risk management programs
 - Working group members provided comments according to the Scope of Feedback criteria provided in slide 10
 - MACD incorporated comments and feedback from working group members
 - The group also exchanged ideas, opinions and experiences of ICP-8 related subject matter

- Information included in the Statement of Approach:
 - MACD's high-level views on the "presence and quality" of ICP, in the context of an enforcement matter
- Information not included in the Statement of Approach:
 - MACD's complete method or processes to evaluate an ICP for "presence and quality" or to establish MACD's threshold for a successful ICP review for any market participant
 - Advice or description of what defines an "organizationally suitable" ICP
 - Background and/or educational information on enforcement processes, or ICP value outside of an enforcement context
- As MACD's views of "presence and quality" evolve, the Statement will be revised and reissued

- MACD sought feedback from working group participants in two areas:
 - Is the Statement of Approach clear in its description of MACD's approach to ICP reviews?
 - Are there challenges and risks your organization may face in implementing an ICP? (These comments will help MACD prepare for ICP reviews.)
- Out-of-scope feedback included:
 - Comments that were outside the purpose of the Statement of Approach (see slide 9)
 - MACD's selection of the Principles, Considerations and Attributes of the ICP review model
 - The importance or effectiveness of ICPs in driving market rule compliance and supporting the IESO's mandate

Statement of Approach on ICPs

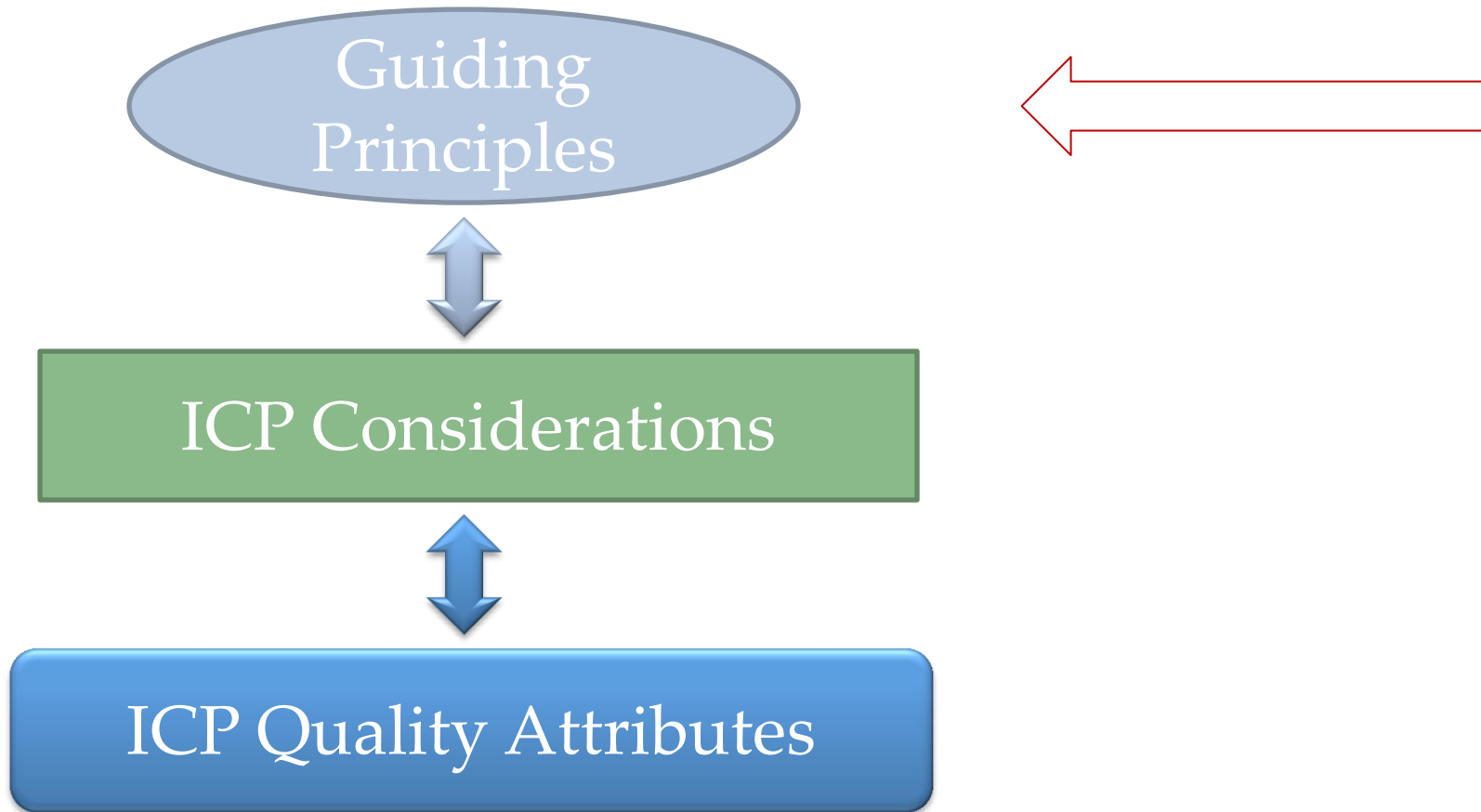
ICP Reviews: Principles and Considerations



- The information provided by MACD should be useful to MPs in several ways:
 - It reinforces the importance of ICPs as a way for MPs to manage their compliance obligations
 - It should help MPs prepare for and respond to enforcement matters
 - It should help MPs understand the principles and considerations that will inform MACD's ICP reviews
 - It should encourage the widespread development of organizationally suitable ICPs

- Striving for a simple and clear approach
 - To enable both MACD and market participants to be effective and efficient in their respective operations
- Focus is on encouraging market participants to be proactive in designing, developing and implementing effective ICPs
 - Encourages innovation – new and better ways to achieve compliance
 - Supports ICPs that are tailored to each organization's unique structure, risks and business operations
 - Review approach is flexible rather than prescriptive

MACD's Approach to ICP Reviews



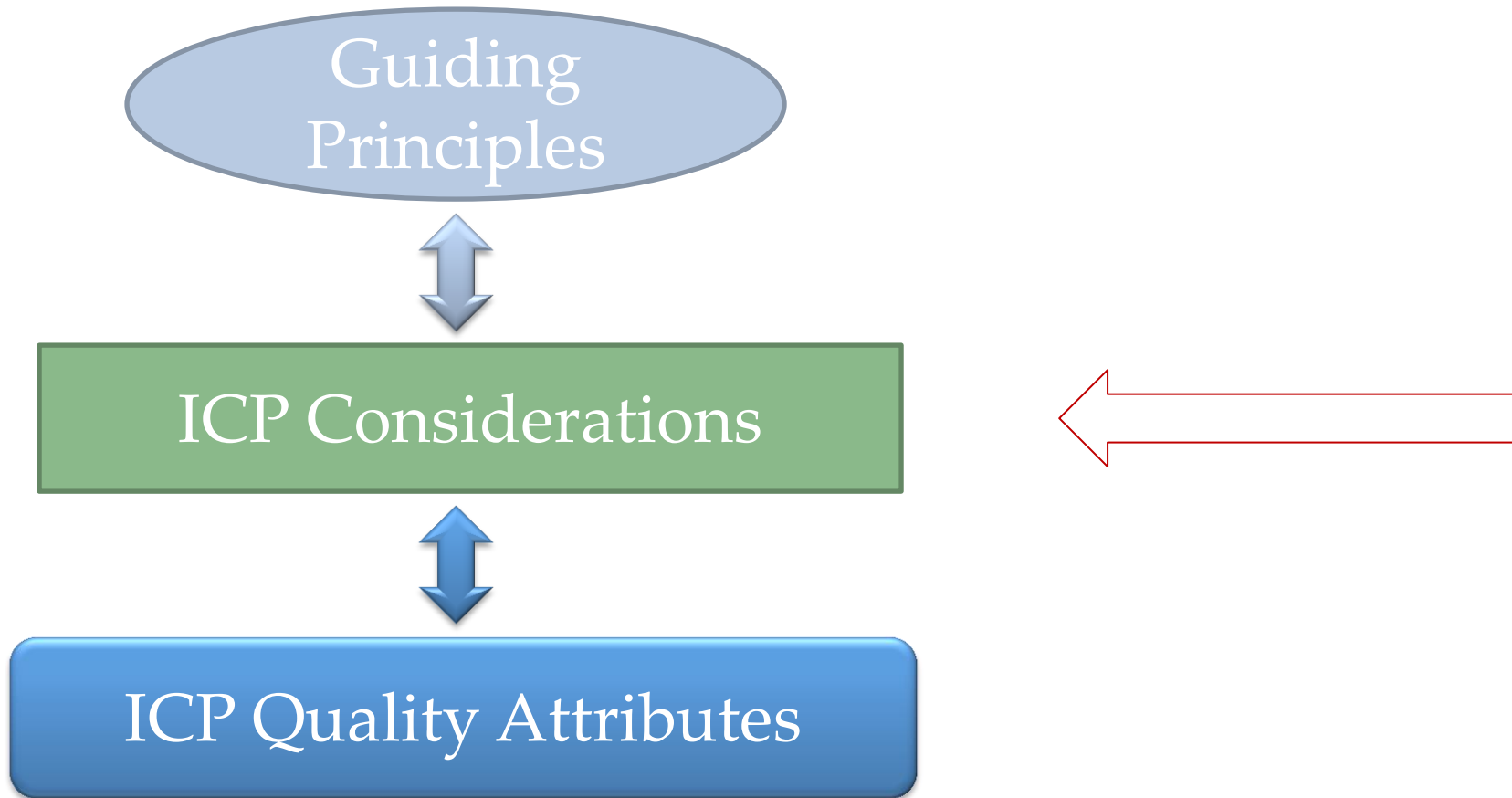
- MACD's approach to ICP reviews is flexible enough to accommodate all the variations we're likely to encounter in ICP structure and scope
 - Focus on desired compliance outcomes
 - One size does not fit all
 - Recognition of the states of maturity of ICPs in the electricity sector
 - Risk-based, organizationally suitable ICPs

- Why does MACD want to focus on outcomes?
 - To hold market participants accountable for delivering desired compliance outcomes, not the manner in which they deliver them
 - To cultivate changes in organizational behaviours and culture that will lead to improved compliance results
 - To encourage a longer term focus by MACD and market participants
 - Leaves market participants to innovate in their design of ICPs
 - Encourages market participants to think strategically
 - Frees market participants from reliance on generic, regulator-determined ICP design

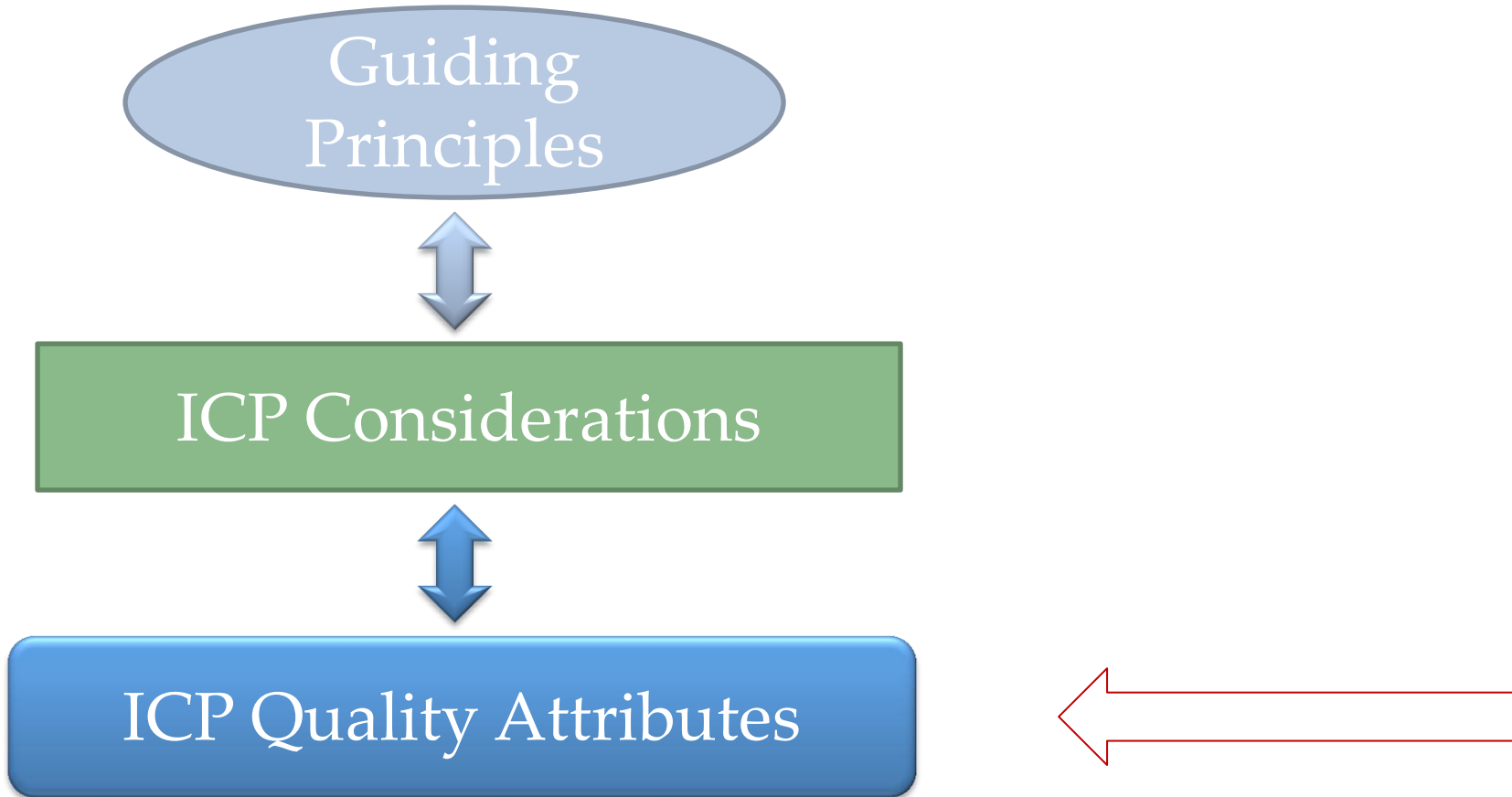
- What are the benefits of building in flexibility?
 - Gives more control and accountability to market participants, making them more likely to manage their risks effectively
 - Allows for new and different approaches to managing compliance
 - Market participants can be flexible in addressing new challenges and adapting to changing circumstances
 - Encourages efficiencies; market participants can use different, more efficient ways to deliver outcomes
 - Flexibility to review a program that achieves compliance outcomes in different ways

- Why is it important for MACD to take into account the current state of development of ICPs in Ontario?
 - Appropriate to recognize different ICP maturity levels
 - MACD views quality as a continuum whereby the quality of ICPs will improve as ICPs mature
 - Improvements in the quality of ICPs generally correlate to decreases in risks to compliance
 - Maturity attributes and characteristics will inform MACD's expectations during a review of ICPs
 - Likely to see different components of an ICP at different states of development and maturity
 - Scale to different industry sectors and size
 - MACD does expect the quality of ICPs to improve for most market participants

- Why encourage risk-based decision-making within ICPs?
 - Encourages market participants to proactively manage their compliance risks and monitor, measure and achieve improvements in compliance with the market rules over time
 - Encourages market participants to understand their risks and unique circumstances and develop ICPs accordingly
 - Allows market participants to focus their resources on areas of highest risk to compliance
 - Allows MACD to focus on areas of highest risk to IESO mandate (grid reliability and market efficiency)
 - Aligns expectations for ICP quality, as well as approaches to reviewing ICPs, according to risk
 - Consistent with approaches within and outside the North American electricity industry



- Considerations that have, and will, inform MACD's review of ICPs in the future
 - Signal to market participants the areas of greatest interest to MACD, when reviewing an ICP
 - Market participants can use the considerations to prepare for a potential enforcement matter, as required
 - Organized as a set of components relevant to an ICP review
 1. Organizational Leadership and Culture of Compliance
 2. Compliance Standards and Procedures
 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 Action



Quality Attributes in Maturity Model

- To help market participants obtain a better understanding of “presence and quality,” MACD has defined a set of quality attributes
 - Describes attributes or characteristics of an ICP organized into different states of maturity
 - Places quality on a continuum but should not be interpreted to mean that MACD expects market participants to be at State 5 for each of the considerations
- Model for ICP maturity in the Ontario electricity sector
 - Helps MACD to gauge quality relative to risk and importance to grid reliability and market efficiency
 - Intent is not to precisely measure performance levels
 - Helps to take a long-term approach to encouraging the development of quality ICPs
 - Enables market participants to strive for performance improvements within their ICPs
- Consistent with generally accepted practices
 - While best practices were considered, MACD calibrated the levels of maturity to reflect Ontario’s electricity industry
 - Quality attributes complement other frameworks
 - MACD’s approach is complementary to, and can be used in conjunction with, other risk and internal control frameworks (eg. Committee of Sponsoring Organizations (COSO) internal controls framework)
 - Avoids duplication and is complementary to industry initiatives, such as NERC’s Reliability Assurance Initiative
 - Provides a wider set of resources to market participants in their ICP initiatives 25

Organizational Leadership

Little to no
compliance
oversight
exists

Compliance
oversight is
largely
informal and is
not
independently
exercised

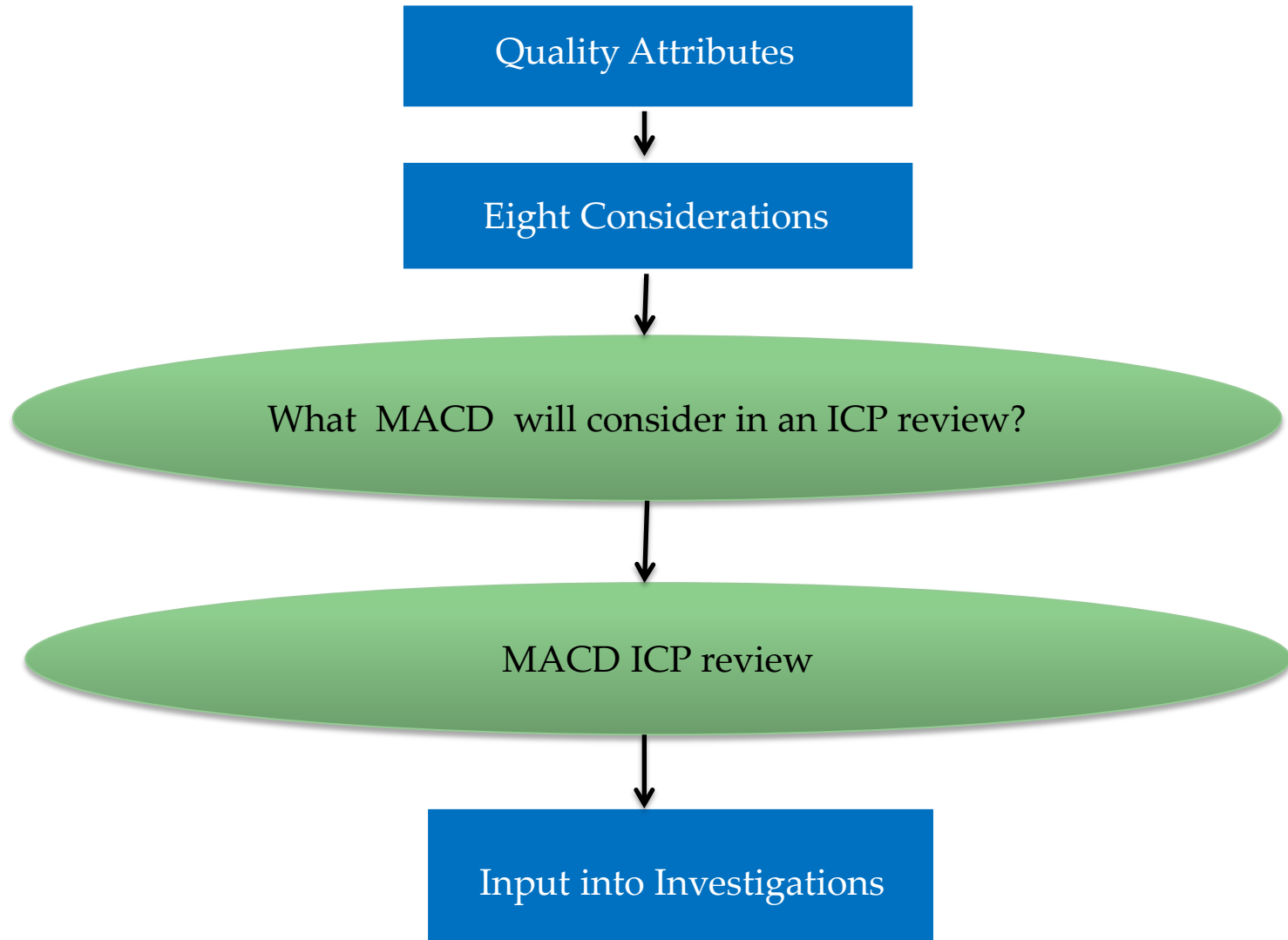
A formal
governance
structure for
compliance
oversight is
emerging
which includes
an
independent
perspective

The
governance
structure for
compliance
oversight is
independently
controlled

The
governance
structure for
compliance
oversight is
fully
independent
and self-
directing



Quality increases and risk of non-compliance decreases

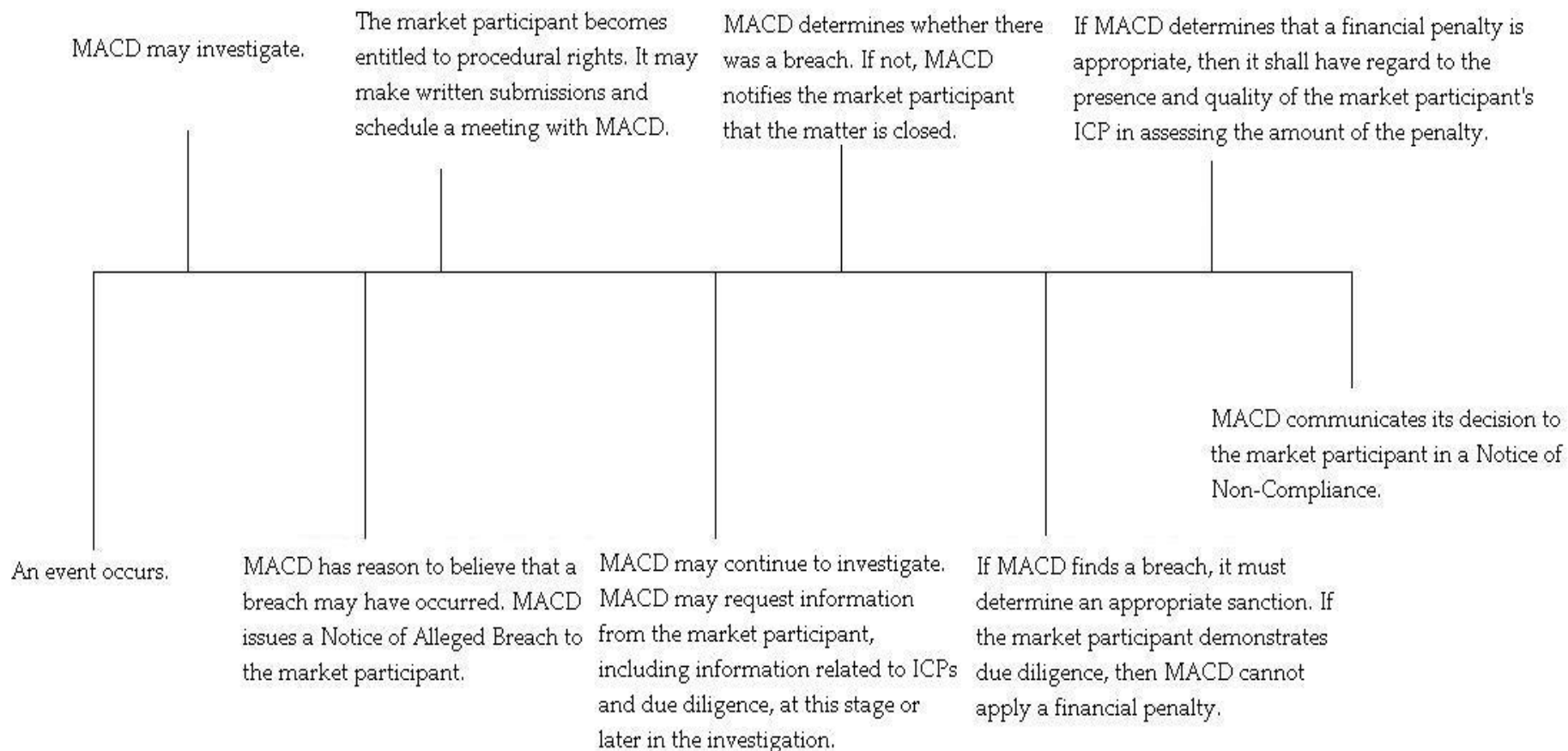


Quality Attributes: Not the Whole Quality Picture

- Attributes are not criteria or a checklist for MACD to determine quality and do not show the whole picture of quality
- Eight considerations – whether and how these considerations are implemented plays a large role in MACD's assessments of quality
- Market participants should develop an ICP tailored to their own organizational needs

Integration With Enforcement Processes

Investigative Activities and Events: ICP Considerations



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

- Any ICP is better than no ICP
- MACD is required to examine several factors to determine a financial penalty, one of which is 6.6.7.13, “presence and quality” of an ICP
 - ICPs are generally a mitigating factor in determining a penalty. However, in certain circumstances, the lack of an ICP may be an aggravating factor in determining a penalty
- On a case-by-case basis, an ICP may help market participants demonstrate due diligence
- A financial penalty cannot be imposed if a market participant can demonstrate that the exercise of due diligence could not have prevented the breach

Next Steps

- Review background material (decks and FAQs) and Statement of Approach
 - Focus on clarity of the Statement of Approach
 - Identify barriers to organizational implementation
- Provide written comments, if any, according to Purpose of the Statement and Scope of Feedback (slides 9 and 10) by December 13 to MACDInbox@ieso.ca
 - MACD will review comments, revise the documents where warranted, and post the “Statement of Approach” by the end of the year
 - Supporting documents to follow shortly after, including response to stakeholder comments
- A recorded presentation will be available early in 2014

Questions?