

SCCE Utilities & Energy Compliance & Ethics Conference

Hot Ethics and Compliance Topics In Energy Marketing and Trading

March 3, 2010

Presented by Mike Scheller

PRICEWATERHOUSECOOPERS 

Agenda

Emerging Trends in Marketing and Trading Compliance Programs

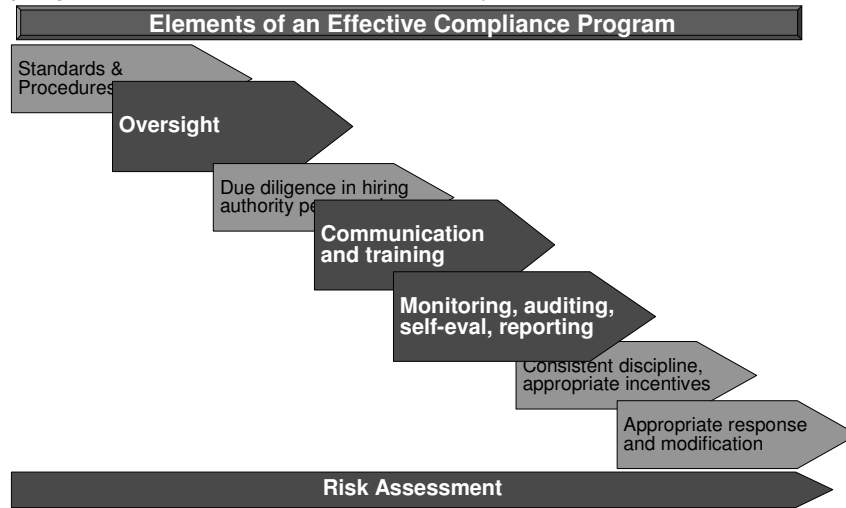
- Risk Assessment
- Roles and Responsibilities
- Training
- Monitoring, Auditing, and Self-reporting
- Communication Recording
- Transaction Analysis

Open Discussion on Current Topics

- CFTC Regulation of Energy Markets
- FERC Reporting
- Others

Overview

Federal Sentencing Guidelines provide structure for compliance programs—we will focus on a few key elements



Overview



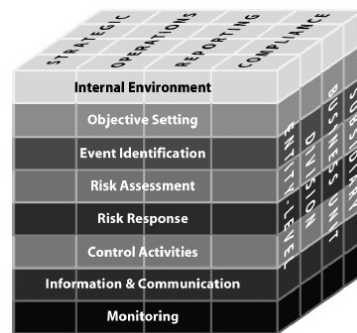
Why Risk Assessment?

- FSGO element
- Means of tailoring program to company's business (as suggested by FERC Policy Statement on Compliance)
- Rational method for allocating limited resources—provides adequate coverage without over-investment

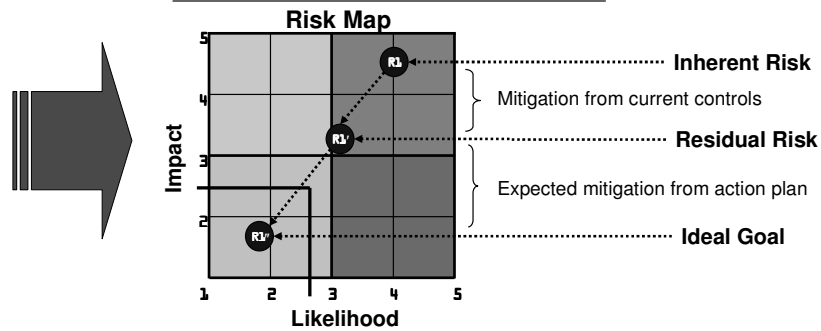
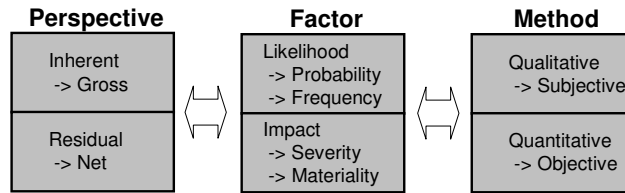
Foundational Methodology: COSO Enterprise Risk Management Framework

Three Foundational Aspects:

1. Starts with objectives:
 - Strategic
 - Operations
 - Reporting
 - **Compliance**
2. Applies to activities at all levels of the organization
3. Has eight interrelated components



Compliance Risk Assessment Framework



Risk assessment is applied first to inherent risks. Once risk responses have been developed, the organization then considers residual risk.

Inherent -> Gross Inherent risk is the risk to an entity in the absence of any actions the organization might take to alter either the risk's likelihood or impact.

Residual -> Net Residual risk is the risk that remains after the organization's response to the risk. Risk assessment is applied first to inherent risks.

Risk Assessment

Likelihood represents the possibility that a given event will occur, while impact represents its effect.

Likelihood
-> Probability
-> Frequency

- **Likelihood** : Estimated possibility : more subjective and qualitative
EX : Low, medium, high
- **Probability** : Estimated possibility : more objective and quantitative
EX : 10% per year, 50% per month
- **Frequency** : Based on actual experience. Times or cases of happening
EX : 5 times per year, 10 cases per month

Impact
-> Severity
-> Materiality

- **Financial** : Regulatory penalties, loss of assets, restitution,
- **Reputation** : Damage to the company's reputation in the minds of key stakeholders
- **Service failure** : The delay reduction or cessation of activity or service supplied to customers.
- **Employee dissatisfaction** : Detriment to the morale and/or commitment of our staff
- **Legal/regulatory** : Claims or charges; regulatory actions

9

Risk Assessment

Challenges

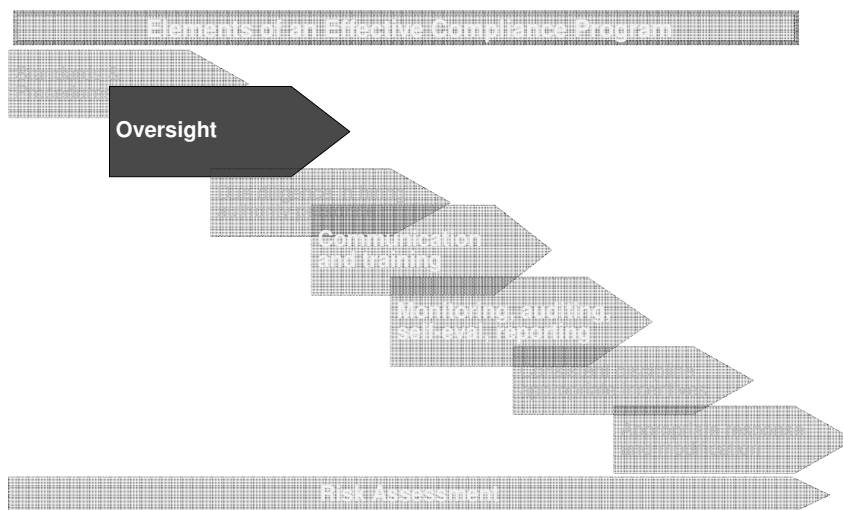
- Inherently subjective process
 - Whose opinion weighs heaviest?
 - Top of mind issues rise to the top of the list
 - Apples and oranges
- Difficulty measuring all impacts
 - Inherent risk somewhat theoretical
- Competing risk assessments; leveraging ERM and Internal Audit
- Check the box mentality
- Temptation to view as episodic activity
- Level of detail - how far down to drill

10

Risk Assessment

Questions to ask in evaluating your risk assessment?

- Are the risks related to all compliance requirements being adequately assessed, at the right level of detail?
- Do risk assessments yield new information or a fresh perspective that assists in allocating compliance resources?
- Does the process enable two-way information flow?
 - Re-assessing risk based on events in the company, or in industry
 - Using risk assessment information to drive training, monitoring, and control enhancement



Oversight

Who “owns” your trading compliance program?



Oversight

Questions to ask in identifying roles and responsibilities?

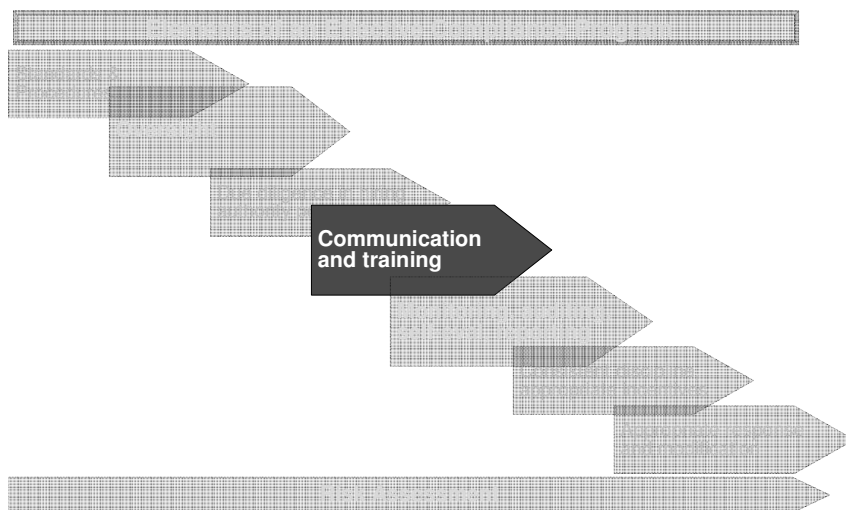
- Who is the senior management member responsible for maintaining compliance with trading regulations?
 - How do they evaluate the state of compliance?
 - Do they underscore the importance of compliance, or is it viewed as a “check the box” exercise?
- What parts of the organization play a supporting role?
 - Providing expertise and legal/regulatory advice?
 - Sourcing, creating, and delivering training?
 - Monitoring for compliance with laws and regulations?
- Are responsibilities codified and consistently understood?
- What is the relationship among the key players?

Oversight

Observations

- Front office leadership buy-in and support is critical to success—especially with regard to setting the tone.
- Trading background is important for key players—this is a specialized skillset (think safety or employee relations)
- Look to leverage groups with existing expertise and tools
 - Risk management
 - Internal audit
- **If tomorrow you asked 10 employees who is responsible for trading compliance, would they give the same answer???**

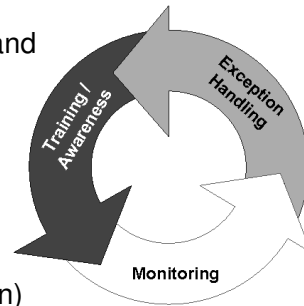
15



16

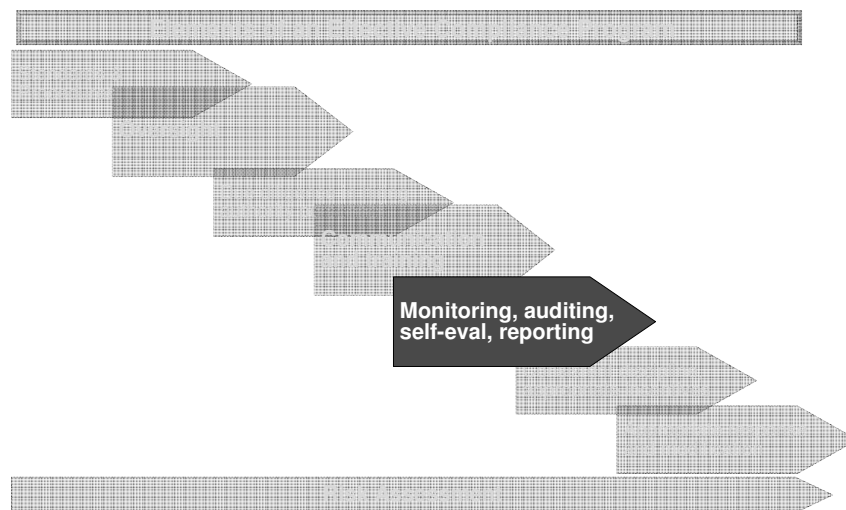
Training Considerations

- Common gap: “employees will conduct business in compliance with all applicable laws and regulations” (from code of conduct)
- Relevant, role-specific training equips employees to make good decisions
- Initially, base topics on risk assessment
- Feedback loops keep training relevant and help close gaps (see graphic)
- Some sample topics:
 - ISO rules
 - Affiliate transactions
 - CFTC regulations
 - Standards of Conduct (most common)



17

Overview



18

Trends in Uses of Technology

- Energy trading is a data-intensive enterprise
- Effective monitoring and auditing will require some use of technology for data review and analysis

Data analysis may be classified by purpose and type of data

Purpose

- **Investigation** : Fact-finding effort in response to a specific event (e.g., allegation of fraud, regulatory inquiry)
- **Ongoing Monitoring**: Routine internal monitoring as part of compliance controls

Data Type

- **Unstructured**: Administrative documents or communication (e.g., emails, instant messages, word documents)
- **Structured** : Application-specific data (e.g., customer billing records, trading data, transmission service requests)

The analysis and objectives vary with data type and purpose

	Investigation	Ongoing Monitoring
Unstructured Data	<ul style="list-style-type: none"> – Email, communication, or document searches – Minimal interpretation required – <u>Objective</u>: Identify all documents/communication related to a specific issue 	<ul style="list-style-type: none"> – Analysis of recorded/archived communications--voice, email, or instant message – Can be time-intensive... technology can offset – <u>Objective</u>: ID potential inappropriate behavior
Structured Data	<ul style="list-style-type: none"> – Analysis of transaction data related to a specific issue – Significant interpretation and analysis required – <u>Objective</u>: Retrospectively evaluate market behavior 	<ul style="list-style-type: none"> – May involve automation or manual analysis – Can sometimes leverage Risk Management tools – <u>Objective</u>: Detect unwanted behavior in time to take corrective action

Communication monitoring considerations

	Investigation	Ongoing Monitoring
Unstructured Data	<ul style="list-style-type: none"> – Email, communication, or document searches – Minimal interpretation required – <u>Objective</u>: Identify all documents/communication related to a specific issue 	<ul style="list-style-type: none"> – Analysis of recorded/archived communications--voice, email, or instant message – Can be time-intensive... technology can offset – <u>Objective</u>: ID potential inappropriate behavior
Structured Data	<ul style="list-style-type: none"> – Analysis of transaction data related to a specific issue – Significant interpretation and analysis required – <u>Objective</u>: Retrospectively evaluate market behavior 	<ul style="list-style-type: none"> – May involve automation or manual analysis – Can sometimes leverage Risk Management tools – <u>Objective</u>: Detect unwanted behavior in time to take corrective action

- To record or not?
 - What are your counterparties' policies?
 - Other requirements (e.g., confirms or dispute resolution)?
- How to analyze
 - Random sampling
 - Risk-based searching
- Technologies
 - Email / IM (easier)
 - Voice (more difficult)
 - Dealing with attachments
 - Refining the filters and dealing with false positives

Communication monitoring considerations (cont'd)

Identification	Ongoing Monitoring
Identify all communications subject to a specific review	Analyze all communications subject to a specific review
Analyze all transactions that subject to a specific review	Can be time-intensive
Identify all communications subject to a specific review	Can be time-intensive

- Other considerations
 - How long should you retain discretionary recordings (i.e., those not subject to FERC retention requirements?)
 - Who is authorized to access recorded transactions?
 - What is the company's policy on recorded communications (HINT: You should have one.)
 - How should breaches of policy be handled and documented?
 - What type of business communications training do you provide?

Analysis of transaction data presents challenges

Identification	Ongoing Monitoring
Identify all communications subject to a specific review	Analyze all communications subject to a specific review
Analyze all transactions that subject to a specific review	Can be time-intensive
Identify all communications subject to a specific review	Can be time-intensive

- Volume of data
 - Period of inquiry, type of transactions
 - Recent transmission operations project: > 3 terabytes, > 1 million transactions
- Integration
 - Multiple-source data
 - Examples: Trading and scheduling systems, physical and financial trading systems, OASIS and AFC calculation tools
- Team composition
 - Coordination between data and content specialists
 - Experience is key—time constraints often present a special challenge

Transaction monitoring can form a key component of a compliance program

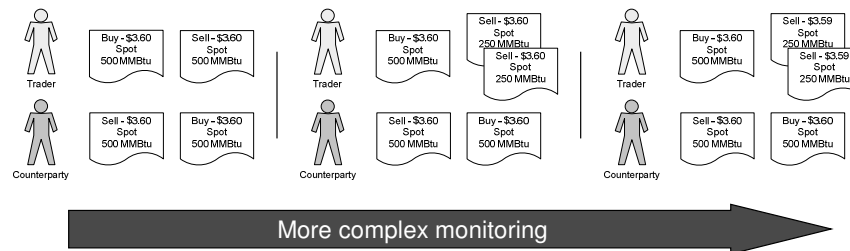
	Transaction Monitoring	Quality Monitoring
Definition	Process of identifying and detecting suspicious or unusual activity in a transaction.	Process of identifying and detecting suspicious or unusual activity in a transaction.
Objective	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Scope	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Methodology	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Tools	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Challenges	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Benefits	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.

- Identify key risks and their “signatures”
 - What behaviors represent potential compliance breaches?
 - How would these manifest in transaction records (price, volume, position, counterparties, etc.)
- Create business rules to detect signatures
- Leverage mid-office / risk management technology
- Goal is to help focus limited compliance resources on areas of greatest concern
- Most companies start small, then expand as needed or as resources permit

Example – wash trade detection

	Transaction Monitoring	Quality Monitoring
Definition	Process of identifying and detecting suspicious or unusual activity in a transaction.	Process of identifying and detecting suspicious or unusual activity in a transaction.
Objective	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Scope	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Methodology	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Tools	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Challenges	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.
Benefits	Identify and detect suspicious or unusual activity in a transaction.	Identify and detect suspicious or unusual activity in a transaction.

- Commonly-monitored risk
- Varying levels of sophistication are possible
- “Building block” approach is common



Agenda

Emerging Trends in Marketing and Trading Compliance Programs

- Risk Assessment
- Roles and Responsibilities
- Training
- Monitoring, Auditing, and Self-reporting
- Communication Recording
- Transaction Analysis

Open Discussion on Current Topics

- CFTC Regulation of Energy Markets
- FERC Reporting
- Others

PRICEWATERHOUSECOOPERS 

Other Topics

CFTC Regulation of Energy Markets

- Proposal to establish speculative position limits for crude oil, natural gas, gasoline, and heating oil
- Aimed at curbing large position accumulation by “energy speculators” (end-user hedge exemptions would exist)
- Implications
 - Minimal for commercial players (aimed primarily at large speculative positions)
 - Potential liquidity impacts
 - Additional training, reporting requirements?
- Currently in public comment period (closes April 26)

Other Topics

FERC Reporting

- Electronic Quarterly Reports (EQR)
 - Mature process for reporting wholesale electric power transactions
 - Mandatory for market-based tariff holders
 - Proposed change: Requirement for non-jurisdictional entities to file (in public comment period)
- FERC Form 552
 - Annual report of natural gas transactions physical next-day or next-month
 - Identify fixed vs. index price, aggregate quantities
 - New report (2009 first year)...your experiences?

29

Open Discussion



Presenter

Mike Scheller
Director
Chicago
(312) 298-3074
michael.j.scheller@us.pwc.com

Mike will serve as your engagement director, and will ensure the outcome of the project meets your expectations. He is a leader in the Firm's Regulatory Compliance practice for energy and utility companies. In this role Mike helps clients develop risk-based programs to more effectively manage controls and mitigation.

He has led over a dozen ethics and compliance related projects for energy and utility companies. These projects have addressed clients' ethical compliance programs, and have also focused on a variety of specific regulatory topics. He has led projects related to CFTC and futures exchange compliance for a trading and marketing business; open access transmission compliance for a multi-state utility; fraud risk assessments; compliance risk assessments; and assessments of FERC Standards of Conduct (Order 2004) compliance programs.

Mike is an active speaker on ethics and compliance topics within the energy and utility industry and has delivered presentations on ethics and compliance topics to the American Gas Association, Edison Electric Institute, Federal Energy Regulatory Commission, and Risk and Insurance Management Society. In addition, Mike instructs ethics and compliance related courses for PwC practitioners. Prior to joining PwC, Mike served as a Civil Engineer Officer in the U.S. Air Force.