

Best Practices For CFTC & FERC Compliance Programs

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Agenda

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- The Full Support of Senior Management
- Training and Communication
- Effective Preventive Measures
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- Reviews and Audits of the Compliance Program
- What Not To Do!
- CFTC, CME, & ICE Supervisory Regulations
- Overview of the CFTC's Regulation of Energy Markets
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Robust Compliance Programs

- The program should be operated and managed with appropriate independence.
- For example, compliance officials should report to or have independent access to the chief executive officer, the board of directors, and/or to a committee thereof.
- Companies should appropriately integrate compliance personnel into the organization's business lines.

Robust Compliance Programs, Cont.

- Compliance personnel should have the authority to:
 - implement compliance procedures;
 - report compliance failures;
 - remedy those failures or deficiencies without interference from the business units;
 - require trading personnel to heed their compliance advice; and
 - If compliance personnel provide advice on a compliance or regulatory matter or issue, traders and business unit managers should not be permitted to ignore that advice unilaterally.

Robust Compliance Programs, Cont.

- A robust compliance program will -
 - Be well documented, promoted and enforced consistently.
 - Provide incentives to perform in accordance with the compliance and ethics program.
 - Provide for reasonable and appropriate disciplinary measures for engaging in violations and for failing to take reasonable steps to prevent or detect violations.
 - Promote compliance by identifying measurable performance targets.
 - Provide a system with mechanisms that allow for anonymity (e.g., internal hotline) or confidentiality, whereby the company's employees and agents may report or seek guidance regarding potential or actual violations without fear of retaliation.
 - Include procedures for resolving disputes between compliance personnel and the trading organization or a process by which the trading organization can seek a reevaluation of an issue when it disagrees with compliance advice.

Robustness and Resources

- Compliance must have sufficient resources to:
 - hire the requisite number of employees with the appropriate skills and experience;
 - provide adequate compensation and incentives to recruit and retain skilled compliance personnel;
 - invest in technology resources to monitor trading, trader communications, and compliance with internal controls;
 - evaluate, on a regular basis, the ongoing effectiveness of the organization's compliance program; and
 - maintain, update, and improve the organization's compliance-related technology resources.

Full Support of Senior Management

- Compliance should be fully supported by senior management.
- Senior management shall be knowledgeable about the content and operation of the compliance and ethics programs.
- Senior management shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.
- Senior management should communicate its commitment to compliance frequently and, both formally and informally, to employees.
- Senior management should actively encourage employees to raise questions and to obtain the views of supervisors and designated compliance personnel.
- Senior management should assure that compliance personnel are appropriately included in the development of new transaction structures, business initiatives, and trading strategies.

Training and Communication

- Compliance, with the support of senior management, needs to take steps to communicate the firm's standards and procedures, and other aspects of the compliance and ethics programs, to management and employees.
- Conduct effective training programs and tailor information to individuals' respective roles, responsibilities, and the trading activities.
- Document and track training participation.
- Track and disseminate new information in a timely manner to ensure that both compliance personnel, traders, and employees have the most up-to-date regulatory information.

Effective Preventive Measures

- Appropriately summarize and document trading strategies to assist compliance with understanding the trading activities for the compliance reviews.
- Maintain a list of prohibited trading strategies.
 - A best practice to discourage traders from using physical energy products to benefit financial positions is to require documentation of all trading strategies that involve trading related physical and financial products. This documentation should explain the rationale for the strategy (e.g., a hedge) and describe the circumstances under which the strategy might be used.
- Limiting the size of open financial positions can minimize a trader's incentive to try to move a price to benefit his or her financial positions.
- Require traders to obtain approval from compliance, their managers, or both, before trading new products or at new locations.

Detection and Cessation

- Prompt detection may result from a high-quality monitoring system, actively-promoted company hotline, or other measures to ensure that transactions are reviewed for conformance to regulatory requirements on a real-time basis.
- Monitoring trades and position concentrations in particular markets and products can assist in identifying areas in which a trader might push a price to benefit a related financial position.
- Record, retain, and regularly review trader communications to identify any potential issues or indicators of misconduct.
- Compliance personnel should understand profitability metrics at a sufficiently granular level to assist them in identifying misconduct.

Remediation

- After a violation has been detected, the company should take reasonable steps to respond appropriately to the violation and to prevent further similar violations, including making any necessary modifications to the company's compliance and ethics programs.
- Adopt and ensure enforcement of new and more effective internal controls and procedures to prevent a recurrence of misconduct.

Remediation, Cont.

- As to employees engaged in misconduct, the issue of whether disciplinary action is appropriate (*e.g.*, reprimand, suspension, reduction in pay or bonus, termination, etc.) depends on the circumstances surrounding the offense and the involvement of supervisory personnel or senior management.
- Companies should have policies that require following up on and documenting all alerts of potential noncompliance.

Compliance Reviews & Audits

- Compliance reviews and audits should address whether:
 - the training program continues to be effective in ensuring that employees understand their compliance obligations;
 - the organization’s monitoring tools continue to be able to detect potential compliance issues and misconduct;
 - compliance-related IT resources require updating;
 - the process for updating an organization’s compliance materials has been effective at keeping them current;
 - all compliance issues and disciplinary actions have been addressed and documented and whether any changes should be made to the organization’s compliance program in light of those issues; and
 - compliance personnel are performing their responsibilities fully.

Compliance Reviews & Audits, Cont.

- An essential element of assessing performance of a compliance program is using what's learned during the assessments to make improvements, thus:
 - documenting all of the issues identified during the audits and taking action to improve the compliance program; and
 - in subsequent audits, evaluating whether any weaknesses still exist in the areas previously identified.

What Not To Do . . .

- Providing insufficient funding for the organization's compliance program.
- Failing to regularly reassess and update compliance practices as circumstances change.
- Setting compliance-related rules, limits, and restrictions and then failing to monitor for violations or discipline those who violate rules in a meaningful way.
- Reliance on the use of off-the-shelf compliance tools without customizing them for specific needs and the business.
- Overreliance on standardized and long annual training.
- Implementing policies that inhibit or prohibit the retention of trader communications.

Certain FERC Compliance Guidance

- See *Revised Policy Statement on Enforcement*, 123 FERC ¶ 61,156 (2008).
- See *Staff White Paper on Effective Energy Trading Compliance Practices at P 6*, available at <https://www.ferc.gov/legal/staff-reports/2016/tradecompliancewhitepaper.pdf> (November 2016).
- See *Revised Policy Statement on Penalty Guidelines*, 132 FERC ¶ 61,216.
- See *Policy Statement on Compliance*, 125 FERC ¶ 61,058

Applicable CFTC Regulations

- CFTC Rule 166.3 – Failure to Supervise
 - Requires a firm to employ diligent supervision of its employees and activities:
 - Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

CFTC Supervision, Cont.

- CFTC Rule 166.3 – Failure to Supervise, Cont.
 - 166.3 is violated when:
 - A registrant’s supervisory system was generally inadequate; or
 - A registrant failed to perform its supervisory duties diligently. (See *In re Forex Capital Markets LLC*, [2012-2013 Transfer Binder] Comm. Fut. L. Rep. (CCH) ii 32,658, at 73,166 (Oct. 3, 2011))
 - Evidence of violations that “should be detected by a diligent system of supervision, either because of the nature of the violations or because the violations have occurred repeatedly” is probative of a failure to supervise.
 - Violation under 166.3 is an independent violation for which no underlying violations is necessary. See *In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ii 27,194 at 45,744 (CFTC Dec. 10, 1997).
 - Unlike the SEC’s rule on failure to supervise, which requires an underlying substantive violation in order to establish a failure to supervise charge. See Section 15(b)(4)(E) of the Securities Exchange Act of 1934.

CME & ICE Supervisory Rules

CME

- 432.W – It shall be an offense: for any party to fail to diligently supervise its employees and agents in the conduct of their business relating to the Exchange.

ICE

- 4.01(a) – Every Person shall diligently supervise the Exchange-related activities of such Person's employees and agents. For purposes of this Rule, the term "agent" includes any Exchange-related activities associated with automated trading systems that generate, submit and/or cancel messages without human intervention. Every Person shall also be responsible for the acts and omissions of such employees and agents.

Overview re: CFTC Regulation of Energy Markets

- RTO/ISO 4(c) Exemption – Electricity Markets
- De Minimis
- Capital (*proposed*)
- Position Limits (*proposed*)
- Margin
- Forward Definition: Embedded Volumetric Optionality
- SEF Proposal
- Cross-Border White Paper

Selected Enforcement Cases

- ***EOX Holdings Complaint (Sept. 2018)***: Alleged disclosure of material, non-public information about block trading of energy contracts of its customers on ICE Futures US to ingratiate self to another customer.
- ***Geneva Trading Order (Sept. 2018)***: Spoofing in futures contracts on the CME in commodities, including heating oil, RBOB gasoline, and light sweet crude oil. \$1.5M penalty.
- ***Statoil ASA Order (Nov. 2017)***: Attempted manipulation of the Argus Far East Index, a propane benchmark, to benefit Statoil's NYMEX-cleared swaps position. \$4 M penalty.
- ***Simon Posen (July 2017)***: Spoofing in futures contracts on NYMEX in commodities, including crude oil futures. \$635 K penalty.
- ***Total Gas & Power (Dec. 2015)***: 12/7/2015 - Attempted manipulation of natural gas monthly index settlement prices. \$3.6 million civil penalty.

Panelist Closing Thoughts

Questions



FIA

The logo consists of three characters: 'F', 'I', and 'A'. The 'F' is a solid dark grey blocky letter. The 'I' is a solid dark grey vertical bar. The 'A' is composed of several overlapping geometric shapes: a light green triangle on the left, a darker green triangle on the right, and a light blue trapezoid at the bottom. The background features a faint, light blue grid of lines and a network of thin grey lines with small black dots at their intersections in the bottom right corner.