

Background about this Initiative

What is this initiative about?

MACD has issued information to market participants and the IESO that describes its views on the presence and quality of internal compliance programs (ICPs) within an enforcement context. The primary document MACD has used to communicate those views is called the “Statement of Approach: How Internal Compliance Programs are Considered by MACD.”

What is an ICP? What does it do? Is this a new concept?

At a very high level, for purposes of the Statement of Approach, and in the context of the Ontario electricity market, an ICP is defined as a program that is intended to achieve the outcome of compliance with applicable obligations under the market rules. An ICP is a structured grouping of interdependent components that includes the full scope of processes, people, infrastructure, technology and organizational activities required to achieve compliance with the market rules.

There is no universal standard for a well-designed and effective ICP. Each market participant is encouraged to develop an ICP unique to its own circumstances and suitable to its own organization. This means each market participant should design and implement an ICP according to its own corporate structure, risks and operating environment. As a result, every ICP will likely be different.

ICPs are not a new regulatory or business concept. As other industries have matured, ICPs have been adopted by regulated entities to promote compliance with applicable rules, regulations and standards.

Why is MACD providing this information to market participants and the IESO, and why now?

Compliance with the market rules is critical to the reliability of the IESO-controlled grid and the operation of an economically efficient market. Similar to other enforcement bodies, MACD has approached promoting compliance with the rules in a variety of ways, ranging from preventive means to applying sanctions. At any given time, the selection of approach may shift depending on many variables, either general or specific.

The issuance of this statement represents a general shift in focus to promoting compliance through preventive means. MACD would like to encourage market participants to proactively manage market rule compliance through the implementation of quality ICPs. While MACD has always emphasized breach prevention, a focus shift to ICP reviews is believed to be a more

effective means to promote compliance with the market rules than applying sanctions on a case-by-case basis.

Since 2008, when the market rules were amended to require MACD to have regard to the presence and quality of ICP in the enforcement context¹, MACD's knowledge of ICP presence and quality has matured sufficiently to share its views through the Statement of Approach.

What are the expected outcomes of this initiative?

MACD's main purpose in publishing the Statement of Approach is to support the IESO's mandate under the *Electricity Act, 1998*, which includes operating the IESO-administered markets to promote economic efficiency and operating and maintaining the reliability of the IESO-controlled grid.² Compliance with market rules and reliability standards is critical to achieving this mandate and the development of ICPs by market participants and the IESO promotes compliant outcomes.

MACD encourages the development and implementation of comprehensive ICPs by all market participants and views these programs as paramount to market rule compliance. By creating greater awareness of detection and prevention methods and ensuring potential or actual breaches of market rules are prevented or detected and corrected through the use of internal controls, ICPs can play an important role in managing compliance obligations.

By sharing our views on ICP reviews, including some of the factors that will inform our review of ICP presence and quality, we hope to encourage market participants to develop ICPs that are suitable to their specific structure, size and compliance risks under the market rules.

If MACD changes its views on ICPs in a significant way, will the Statement of Approach be updated?

Yes, if MACD's views on ICPs change significantly, the Statement of Approach will be revised and reissued to ensure market participants are aware of the changes.

About MACD and ICPs

Where does MACD get its authority?

The Electricity Act, 1998 authorizes the IESO to make and enforce market rules in Ontario. The IESO's mandate includes operating the IESO-administered markets to promote economic efficiency and operating and maintaining the reliability of the IESO-controlled grid.

To help achieve the IESO mandate, the market rules are mandatory and enforceable in Ontario. Market participants are obliged to comply with applicable obligations under the market rules.

¹ Chapter 3, section 6.6.7.13, "shall have regard to..." presence and quality of market participant's compliance program"

² See *Electricity Act, 1998*, S.O. 1998, c. 15, Sched. A, ss. 1, 4.

Within the IESO, MACD has been delegated the responsibility to monitor, investigate and enforce the market rules. MACD has the responsibility to investigate and make the determinations assigned to the IESO under the market rules concerning allegations and breaches, including the issuance of orders and financial penalties.

What are MACD's responsibilities with respect to ICPs?

As part of the investigation process, MACD may exercise its authority to request information from the market participant, including information related to the "presence and quality" of the market participant's ICP. In appropriate circumstances, Chapter 3, section 6.2.7 of the market rules allows MACD to impose financial penalties on market participants for breaches of the market rules. In determining the amount of a penalty, Chapter 3, section 6.6.7.13 of the market rules requires that MACD consider "the presence and quality of the market participant's compliance program."

What are market participants' obligations with respect to ICPs?

While MACD encourages all market participants to have comprehensive ICPs and views these programs as important to achieving compliance, market participants are not obliged to implement an ICP under the market rules. However, market participants are required to comply with the market rules.

In addition, market participants are obliged to fully comply with MACD requests for information, including requests for information regarding the "presence and quality" of their ICP. Failure to disclose all information relevant to a MACD request may be a breach of either Chapter 3, section 6.2.4.3, Chapter 1, section 11.1.1 or Chapter 1, section 11.2.1 of the market rules.

ICPs in the Broader Regulatory Context

How did MACD develop its views on the presence and quality of ICPs?

MACD has matured its views on internal compliance programs since the requirement (Chapter 3, section 6.6.7.1.3) to consider the presence and quality of ICPs was introduced into the market rules in 2008. Since that time, MACD has developed a depth of knowledge that informs its decision-making and approach to ICP assessments through its experience with market rule compliance and enforcement in Ontario, and by seeking the advice of a compliance program expert, consulting with Canadian and U.S. electricity industry regulators, and conducting research into compliance programs in other regulated sectors.

Do other electricity regulators require that regulated entities have an ICP?

Some electricity sector regulators outside of North America do require or incent their regulated entities to have an ICP. Moreover, regulators in other industry sectors consider ICPs to be part of an organization's corporate governance mandate, with corresponding obligations to ensure compliance within the sector.

While ICPs are not mandatory in the U.S., the Federal Energy Regulatory Commission (FERC) and the North American Electric Reliability Corporation (NERC) have introduced and encouraged the concept of ICPs as part of an industry-wide strategy to advance compliance.

Since 2008, both FERC and NERC have published documents describing the merits of an ICP and have continued to encourage comprehensive compliance initiatives within the regulated community. In a 2005 Policy Statement on Enforcement, FERC posed 13 questions pertaining to internal compliance, which FERC describes as “an important proactive tool.” The questions point to factors that will be taken into account by FERC in determining credit given for a company’s commitment to compliance. FERC also issued a Revised Policy Statement on Penalty Guidelines in 2010 that provided seven factors for an effective compliance program, which serve as a checklist to organizations for creating effective compliance programs. FERC’s Fiscal Year 2014 Congressional Performance Budget Request states that “the Commission will continue to encourage entities subject to the Commission’s regulatory requirements to develop robust internal compliance programs.” FERC continues to engage in formal and informal outreach efforts to promote effective compliance programs and examine compliance practices as a standard component of investigations, and has incorporated reviews of compliance programs into its compliance audits.

Benefits of ICPs

What are the benefits of an ICP?

Within Ontario’s enforcement context, ICPs are generally a mitigating factor in determining a penalty. Therefore, from a penalty perspective, having any ICP is better than having no ICP. Also, on a case-by-case basis, an ICP may help a market participant 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.

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.

Does MACD expect all market participants to reach the same level of maturity? Is everyone expected to reach State Five on MACD's Maturity Model?

MACD has developed a set of quality attributes organized by states of maturity. The Maturity Model quality attributes will be used to inform MACD as to whether and how the market participant has implemented the Foundational and Operational considerations in section 4.2 of the Statement of Approach.

MACD does not expect market participants to develop ICPs that are at a particular state of maturity or strive for full maturity (State Five). Rather, the model serves to demonstrate to market participants that MACD's approach to presence and quality reviews is flexible enough to accommodate different states of maturity.

How does MACD intend to find the balance between its view of perceived risks and a market participant's view of perceived risks?

Although MACD's approach to ICP reviews recognizes that all organizations use some type of risk-based approach to making business decisions, the Statement of Approach is not meant to convey that MACD's decisions to pursue breaches or exercise discretion are altered by an organization's risk assessment or risk tolerance established within its ICP.

MACD does recognize 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. It can also resolve breaches through various means, as deemed appropriate.

MACD's ICP Review Process

Does MACD expect all market participants to have an ICP right now? If not, will MACD be providing a time horizon for implementation of an ICP?

While MACD encourages all market participants to have comprehensive ICPs and views these programs as important to achieving compliance, market participants are not obliged to implement an ICP under the market rules. MACD does, however, expect that all market participants fully comply with their obligations under the market rules. MACD will not provide guidance on an appropriate timeline for ICP implementation as it is specific to each organization and its identified risks and risk tolerance.

Is MACD planning to seek a market rule amendment to make ICPs mandatory?

No, MACD is not planning to seek a market rule amendment to make ICPs mandatory at this time.

What is MACD's Approach to ICP reviews?

MACD recognizes that an ICP may take many forms. The principles in the Statement of Approach will inform our general method to reviewing the presence and quality of ICPs and provide sufficient flexibility to accommodate the diversity of market participants (e.g. size, type and structure). The principles also focus on outcomes rather than prescribing a specific ICP design. MACD's review process will not assume a "one size fits all" approach when considering the quality of an ICP.

When can MACD request ICP information? Is it limited to an enforcement action or can it be requested at any time?

MACD will not ask for ICP information outside of an enforcement matter. As part of the investigation process, MACD has the authority to request all relevant information from the market participant, including information related to the "presence and quality" of the market participant's ICP, at any time during the investigation. Accordingly, ICP information may be requested before a breach is determined. However, Chapter 3, section 6.6.7 of the market rules requires that MACD only consider the "presence and quality" of a market participant's compliance program as part of the penalty determination process. As a result, MACD may choose to wait until later in the investigation (when assessing an appropriate sanction) to request ICP information. The nature and amount of ICP information MACD requests may differ depending on the nature and seriousness of the alleged breach.

Can MACD assess the quality of a market participant's entire ICP, or only certain parts of it?

MACD will only review those aspects of an ICP directly related to compliance with the market rules. MACD will not consider those aspects of an ICP unrelated to those obligations, including, for example, those aspects related to compliance with occupational health and safety regulation, environmental regulation, or any other regulations applicable to market participants.

What should we expect during the ICP review process?

During an ICP review, MACD will require substantiating evidence that proves the presence and quality of an ICP.

MACD says its approach to reviewing ICPs will be flexible but what does that mean?

It means that our approach is flexible enough to deal with organizations of different sizes, corporate structures, roles in ensuring grid reliability and efficient market operations, ICP structures, business drivers, nature and complexity of market rule compliance, risks, levels of sophistication, staff size, centralized or decentralized operations, etc.

What are the consequences of having no ICP at all?

When MACD has reached the point in an investigation where a penalty is being determined, market participants will find it is generally favourable to the penalty determination to have an ICP of any quality rather than to lack an ICP.

MACD may also consider the presence and quality of an ICP in its decision on whether and how to pursue a possible breach of the market rules.

Information Handling and Public Disclosure

How will ICP information be handled?

Information provided to MACD about a market participant's ICP will be treated as confidential, in accordance with the *Market Rules* and any other applicable laws.

How and when will MACD publicly communicate ICP review information following an investigation?

MACD may publish information in accordance with Market Manual 2: Market Administration, Part 2.6 – Treatment of Compliance Issues, which states that when a "...market participant has been found to be in breach of the market rules by MACD and a sanction, financial or otherwise, has been assessed, the IESO may publish the name of the offending party and other information relating to the breach."

When MACD has determined a market participant has breached the market rules, it may choose to publicly disclose information regarding ICP reviews primarily to deter other market participants from engaging in the same behaviour, to educate market participants about what types of action or conduct are considered in compliance with the market rules, and/or to share valuable lessons learned.

What happens if information I provide to MACD about my ICP also contains information about possible breaches outside of those MACD is investigating?

ICP information may contain information regarding possible breaches other than the one(s) under investigation. If MACD finds evidence of other breaches during a review of ICP information, it may choose to investigate these possible breaches.