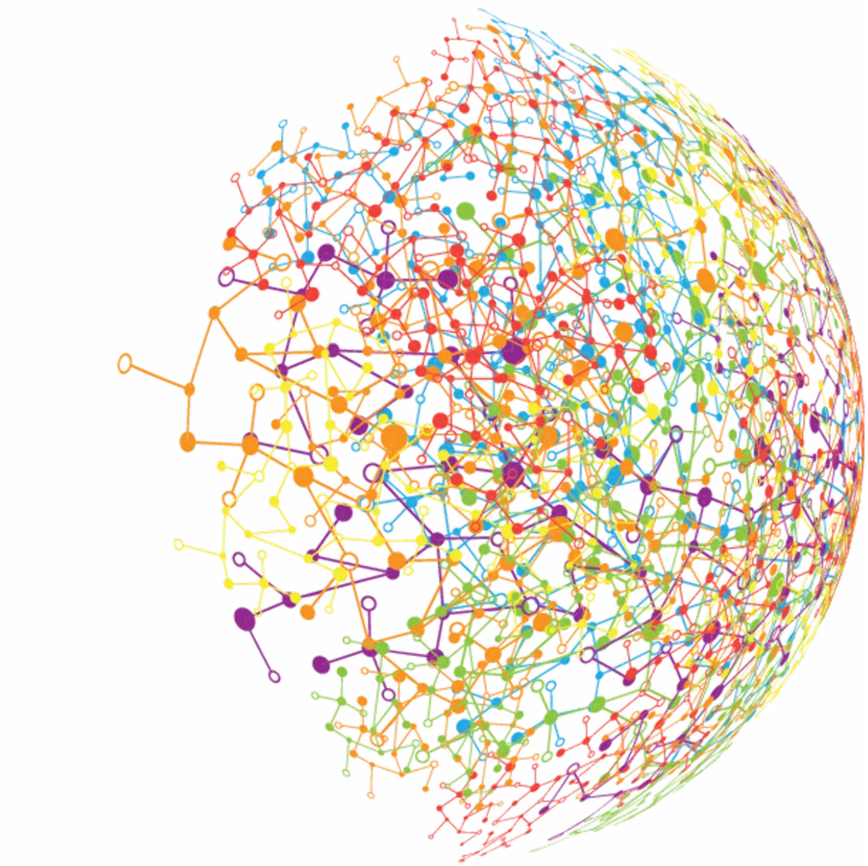

The commodity trader:

Staying compliant in a virtual world

Energy commodity trading, both physical and financial, helps provide a reliable supply of daily resources required to support the continued operation of the macroeconomy. Traders and marketers who are charged with acting on their company's commodity trading mandates, face daily challenges in the execution of this mission. One such challenge includes maintaining margins and/or cash flows in highly volatile price environments exacerbated by ongoing depressed demand and uncertain supply dynamics. This objective should also be balanced against the necessity of having to make significant inventory adjustments to provide reliable supply.

Are the compliance tools and practices enough to provide effective trading oversight and present a strong defense against increased regulatory compliance risks?

By all indications, the shift to a largely virtual trading mode of operation has taken place using a wide variety of enabling technologies and platforms.

What's less certain in this operating environment is whether regulatory compliance risks have increased and whether transacting organizations that are optimizing or speculating with their trading positions have engaged in questionable market behavior. Regardless of the intent, the question emerges as to whether or not the practices are defensible and whether the recordkeeping and reporting can help support a company's behavior in the marketplace. Additionally, are the tools and oversight practices of a trading compliance function able to present a strong defense, and are they sufficient to enable on-going monitoring of remote trading practices?

As parameters surrounding trading have changed, with a greater number of deals now being transacted in a remote environment, additional actions are required to assess if compliance obligations continue to be met. While companies have taken steps to build a solid foundation of capabilities, it has demonstrated to be more difficult given the remote environment, with indications of additional attention needed in three specific areas:

1. **Reporting and recordkeeping**
2. **Monitoring and surveillance**
3. **Trading policies, procedures and guidelines**

As trading compliance and risk management functions continue in their enabling and oversight roles, we offer some perspective below for leadership to take into consideration as you are adjusting your operations to this shifting current environment and uncertain future state.

1.Reporting and recordkeeping

> Remote electronic trading activities test organizational reporting and recordkeeping methods despite federal regulatory requirements easing.

Regulated trading entities have mostly closed their trade floors to comply with social-distancing directives and temporarily moved to fully remote electronic trading, prioritizing focus on essential operational services. Oversight agencies such as the Federal Energy Regulatory Commission ("FERC") and the Commodity Futures Trading Commission ("CFTC") took temporary steps to alleviate regulatory burdens.

Federal requirements easing

The FERC has loosened requirements for ongoing reporting and recordkeeping during the recent crisis.

Oil pipeline, major natural gas, and electric companies can request motions for extension of time to file and even request waivers for certain data collection and report filing obligations such as natural gas transaction reporting and quarterly and annual collection of financial and operational information. Under remote conditions, companies have faced resource constraints and system connectivity issues that have challenged the coordination, compilation, verification, and timely filing of FERC required reports.

Companies that have filed for extensions could face a growing reporting backlog with some of the more frequent quarterly reports at the same time as resources are becoming more constrained and overburdened with the increasingly complicated logistics of returning to work as stay at home orders are lifted. Companies should pay attention to resource capacity and possibly seek outside assistance to recover from reporting requirement bottlenecks.

Likewise, the CFTC has temporarily relaxed some requirements for derivative market participants, including floor traders, that have been displaced from their typical locations. To accommodate remote trading, the CFTC has allowed for alternatives to recording communications related to voice trading and other telephonic communications required to meet audit trail and recordkeeping requirements. Time-stamping requirements have also been relaxed until September 30, 2020.

As an alternative to the standard CFTC voice recording requirements, a detailed written record of the communication is permitted along with documentation of alternative supervisory methods for traders. The CFTC is also providing a 30-day extension for filing Chief Compliance Officer Annual Reports to the Commission.

Challenges with alternate recordkeeping methods

Companies that choose to use the CFTC alternative method of recordkeeping may need to dedicate already strained resources to developing additional documentation of supervisory methods and providing guidance on these new requirements to trading personnel to avoid non-compliance. Companies will need to perform reconciliation of records to verify alternative methods used align with permitted timeframes. Future audit requirements for documentation will also need to be adjusted to accommodate the alternative methods.

Because these alternative methods are not part of an already established process in business continuity plans, these relaxed recording alternatives may be more challenging with many not wanting to break the cadence of familiar recordkeeping and reporting procedures. To decrease the risk of potential non-compliance due to insufficient or improper recording using alternative methods, many traders have been reporting to traditional business sites on a rotational basis to maintain a business as usual approach to recordkeeping and reporting.

In addition, traders have had to increase coordination efforts as an increased number of hand-offs are occurring with a reduced number of staff and activities conducted by staff on a rotational basis. Given the ongoing challenges of adapting trade policies and procedures to remote environments, long term off-site activity for specialty traders may not be an option.

Data validation challenges

Current remote circumstances and processes for data verification and validation have strained the compliance and risk oversight process via additional time and steps introduced into the virtual transaction verification process prior to filing price reports with the reporting agencies. The second line of defense from compliance and risk teams verifying transactional information should maintain firm and complete segregation of duty while maintaining speed and timely oversight under remote conditions.

Compliance and risk teams, like traders, often rely on automated data verification systems or verbal confirmations of data accuracy with traders.

With potential limitations of remote access to those systems and intermittent access to teleworking traders, timely and accurate reporting of transaction data to price reporting agencies has been at risk.

Additionally, with unprecedented commodity market volatility, companies have been dedicating efforts to adapting systems to accurately capture transactions given unprecedented price movements. These events have introduced new hurdles in the transaction verification process executed between traders and compliance and risk teams. Enhanced focus and scrutiny will be required as companies go through both regulatory audits and internal audits to verify complete and accurate transaction data capture and reporting was performed during these exceptional times.

As organizations were adjusting to the virtual environment and focused efforts on sustaining operational reliability, communications processes between trading stakeholders and outside price reporting agencies were still being streamlined.

As such, the number of reported deals fell significantly in March 2020, according to an S&P Global Platts webinar[1]. Internal Audit teams will also need to conduct additional data verification audits to support the movement back to normal business operations in order to decrease non-compliance risk due to gaps in automated verification processes.

Amid all of the activity and work undertaken to support a transition to a virtual environment and a continuity of operations, the global impacts of the crisis have also led to a price collapse in the commodities markets reflected in the West Texas Intermediate (WTI) crude oil front-month futures dropping to negative dollars per barrel for the first time since trading began in 1983. In turn, this has led to heightened concerns of potential market manipulation. It is during times like these that the importance of maintaining data accuracy, integrity, and completeness is paramount.

[1]*S&P Global Platts Looking Ahead: The Energy Transition & Future of Index Development Webinar broadcast online Thursday, April 16, 2020, 10 am – 11 am CDT.*

Considerations to help reduce non-compliance risk:

Review and revise methods of communication for reliable and timely communication between the traders/ supervisors and traders/ compliance and risk teams. This will help support timeliness and accuracy of transaction data, reporting, and recordkeeping under revised regulations and work environments.

Conduct regular close of business day reconciliation meetings between traders and compliance and risk teams to help confirm extreme market conditions are accurately captured during deal entry and errors are dealt with in a timely manner to avoid reporting delays and inaccuracies.

Revise business continuity plans to document alternative supervisory and recordkeeping methods to provide continuity for accurate transactional recordkeeping and reporting activities going forward.

Develop a scenario-based business continuity plan to help ease procedural and recordkeeping uncertainty given different obstacles and challenges. Promoting and maintaining a culture of compliance can be difficult under a range of circumstances and stress conditions.

Keep in mind as recovery begins:

As cyclical reporting and auditing periods restart, special attention should be devoted to periods of remote activities to confirm adequacy of documentation for alternate processes and to confirm accurate transaction execution and compliance with recordkeeping and price reporting requirements were maintained.

Methodologies for trade monitoring should be adjusted to accommodate continued remote operations and remain compliant with surveillance requirements.

While an onsite presence continues to be limited for regulators like the CFTC and FERC, surveillance efforts are continuing with minimal interruptions to uphold proper market activities. While some regulatory recordkeeping requirements have been adjusted to accommodate remote operations, most surveillance activities remain in-tact especially within exchanges. As companies have shifted communication methods and some trade capture practices to alternate means, methodologies for trade monitoring should also be adjusted to comply with surveillance requirements.

Challenges with alternate communication methods

While having to adjust internal communications processes, companies have changed how business is conducted with external parties to support surveillance requirements. With traders moving away from traditional transaction execution venues, alternative methodologies for trading and communication have arisen. While the wide variety of communication platforms offer companies many options for communicating, not all address security with the same level of diligence required by many market participants. Additionally, the plethora of communication options has impacted the uniform monitoring of activity across organizations, including how to effectively communicate, monitor and continue surveillance outside of traditionally recorded communication methods.

Companies should evaluate the integrity of information captured through newly adopted means of communication and assess the risk alternate methods could introduce into surveillance matters. Companies should assess whether internal monitoring processes have been sufficiently adapted for alternative communication processes. If companies adopt temporary non-recorded means of voice trading, such as detailed written records of communications using alternate methods, they should also adapt internal monitoring procedures to safeguard against incomplete information. Taking additional precautions as part of the CFTC's temporary no-action on voice recording requirements will help protect the trader and the company, on the off-chance written records of communication do not satisfy reporting requirements.

Data validation challenges

Risk control teams, charged with compliance oversight for data integrity, accuracy and reporting, rely on effective communication in order to monitor internal alerts and controls, especially in a remote setting. Both risk control teams and traders have been forced to change how they interact and communicate.

Whereas most prior communications occurred in person, virtual environments require alternative communication approaches and can introduce response time delays, increased coordination challenges, and more scheduled interactions in order to review and resolve transaction discrepancies. This challenges effective monitoring in the new remote environment. With so much focus dedicated to operational issues, real-time deal validation has suffered with potentially significant delays now present in deal validation. This can be exacerbated by a potential increase in deal entry errors. A sense of more lax oversight in a work from home culture and new technological challenges, lapses in security protocols and processes, and different user access to data and review processes could potentially contribute to inadequate monitoring at times.

Companies should review and revise procedures for internal monitoring to be more adaptable to flexible work environments. While most will return to normal business sites in the near future in a staggered way, continued remote activity will need to have ongoing support and monitoring. This could potentially lead to concerns around safe harbor and incident reporting from employees. Some companies do not allow back office personnel to have remote access to systems required to fulfill these responsibilities.

Companies should conduct an assessment of unreported incidents due to restricted access rights and create additional means of reporting while maintaining appropriate privacy protocols. Audits of internal processes and controls may be useful to help companies identify gaps in the effectiveness of their monitoring procedures and systems and enable them to develop a more robust compliance program.

Considerations to help reduce non-compliance risk:

As companies revise business continuity plans, **consider establishing and testing a variety of remote communication methods** to determine consistency with approved security requirements and access protocols. Effective and timely communication is imperative to monitoring and surveillance activities including clear and time-sensitive communication of deal adjustments and executions between the first and second lines of defense.

Establish additional controls for policy exemptions when certain surveillance requirements are modified. Traders need specific procedural guidelines and vetted alternate compliance documentation requirements to be in place when exemptions are activated to provide for uninterrupted monitoring and surveillance.

Maintain timely communications with all impacted stakeholders for when temporary policy and regulatory exceptions revert to business as usual operations.

Keep in mind as recovery begins:

While current federal agencies have paused onsite auditing or surveillance, trading organizations should remain within the provided compliance and risk guidelines to prevent the potential for future investigations and, as a precaution if they are, all appropriate documentation is maintained and retrievable. Remote surveillance should continue with increased vigilance given unprecedented market conditions and rising volatility. Be prepared for potential regulatory audits/investigations.

3.Trading policies, procedures and guidelines

> Policies, procedures and guidelines should quickly evolve to accommodate continued remote trading business activities.

While certain trading-related business policies and risk management processes are being challenged across the commercial landscape by the remote environment, it would be short-sighted to fail to recognize the impact on trading policies, procedures and guidelines ("governance documents").

Governance documents also should be reviewed and adjusted to support trading in a remote environment. Specific areas to consider include: recordkeeping of deal approvals; credit risk exposure verification; and trade authorizations requiring multiple levels of leadership review. Additionally, policies and procedures maintaining compliance surrounding trading practices had to quickly evolve to accommodate remote business activities.

As a result of the wide range of changes already discussed, it is important the companies review governance documentation through the lens of making permanent changes that will subsist even as business move back to the traditional onsite model.

Some of the large and more difficult changes include:

- Business continuity plans
- Trade authorizations and credit risk
- Ethical practices and compliance requirements
- Counterparty due diligence

Business continuity plans

New and fast-enacted policies and procedures have been required, possibly through emergency protocol activation. However, the envisioned emergency scenarios were most likely not intended to address the extent of procedures necessary for remote trading activity for such an extensive period and not at a central remote operating site.

Business continuity plans typically focus on intermittent events and sustaining immediate operational needs for a short period of time. Current conditions, however, have required a longer-term adaptability of existing policies and procedures. Policies and procedures should be adjusted as traders move from traditional business sites to remote environments to assure regulatory requirements for deal execution and documentation are followed and regulatory compliances objectives are met. While many activities have been adjusted, the revision of applicable policies have lagged as many companies' focus has been on sustaining operations.

Trade authorizations and credit risk

Monthly solicitations, such as those done during bid-week and seasonal origination activities, typically may require deal approval beyond standard trader level authorization with additional in-person deal verification and confirmation from counterparties. The verification and confirmation can include voice recordings and time-stamps for certain deals and data entered into trade capture systems. It is not uncommon for these systems to only be accessible internally.

Additionally, certain gas-cost mitigation programs approved for utilities need to have additional documentation and support of competitive bidding with sign-offs on credit risk across multiple levels of management and multiple business functions. Under the current market downturn, the risk of insolvency is increasing especially for smaller counterparties. This has created the need for additional scrutiny across multiple business functions supporting traders to verify counterparty challenges are being identified timely and diligently especially for deals done over-the-counter.

For many companies, these activities were not intended to be performed remotely and thus present a challenge to executing them remotely yet in compliance with regulatory requirements.

Policies and procedures will need to be reviewed and may need to change to address how the activities are being performed if the remote environment persists.

Ethical practices and compliance requirements

As traders alternate between on-site and remote activity, special attention should be paid to maintaining awareness with ethical practices and compliance policies and requirements including whether changes need to be documented as remote activities modify how companies monitor and track compliance with the policies and requirements.

For example, if a trader is no longer executing trades on a recorded line and is using an alternative means of communication, how do you guarantee that same ethical approach and culture of compliance is maintained? During times when working from home can lead to a more relaxed environment with a sense of reduced oversight additional attention should be paid to ethical practices and compliance policies as remote surveillance continues and likely continues with additional scrutiny given unprecedented circumstances, volatility and commodity prices.

If an alternate means of trading is being utilized, certain confidential information such as counterparty and price information could be at risk of exposure.

As such, additional procedures should be established to help promote ethical behavior consistent with privacy expectations. One potential approach companies could take is to increase the scope of internal audits to verify all trading activities conducted outside of "standard" means is conducted in compliance with policies and in a way that minimizes potential investigative actions.

Counterparty due diligence

Like many other industries facing challenges with third-party reliability, trading organizations may soon be facing similar risks with trading counterparties. The current instability in the commodities markets is putting many companies on high alert. Volatility in the commodity markets along with demand destruction from the crisis could lead to a reduction in credit-worthy counterparties within the commodity trading sector.

Companies should begin evaluating non-performance clauses to verify contract obligations have been met. Some companies have adjusted internal policies to expedite contract reviews as traditional counterparties may be dealing with operational issues and unable to perform. As a result, trading companies should confirm proper policies and procedures are followed as new counterparties are established through secure document sharing and e-signing even under remote conditions. Special attention should be paid to counterparty on-boarding and the process of keeping the "no trade list" up to date. With CFTC registration relaxation, new procedures and policies for proper notating of exceptions should be established to assure counterparty compliance is maintained.

Considerations to help reduce non-compliance risk:

Assess performance of existing business continuity plans to evaluate how existing policies and procedures should be adapted to allow for longer-term alternate scenarios and work environments. This should be done in the context of maintaining the same level of compliance diligence. Consider how integrating outside perspectives can help provide a thorough industry-wide comparison of existing procedures, identify potential solutions in technological capability gaps that could be limiting effective adjustments in processes, as well as help companies enhance their policies and procedures.

Take stock of the policies and procedures as businesses operations return to on-site to help identify how triggers for regulatory requirements exceptions were treated and how the return to standard requirements is being effectively communicated to all impacted stakeholders. • Take stock of the policies and procedures as businesses operations return to on-site to help identify how triggers for regulatory requirements exceptions were treated and how the return to standard requirements is being effectively communicated to all impacted stakeholders.

Conduct additional assessments of compliance frameworks to identify areas where enhancements to governance are needed to verify compliance with all company policies during remote activities took place.

Develop additional safety policies and precautionary procedures as personnel are set to return to the office. A typical trade floor consists of closely placed quarters of individual desks. Companies should rethink their reintroduction policies and procedures, including rearranging workspaces to maintain social distancing requirements and additional safety requirements. This could include added time to get personnel in through security as these safety measures are enacted.

Keep in mind as recovery begins:

Companies may need to re-evaluate business continuity plans and the associated policies and procedures through a new lens, testing scenarios across functions and against longer timetables for returning to normal operations. As revised business plans are adopted, companies should hold workshops and training sessions to clearly communicate changes and to test newly adopted operating models.

The bottom line.

Evaluate how temporary adjustments in practices are best incorporated into core policies and procedures, with the objective of keeping businesses compliant.

Previously anticipated crisis emergency plans were only foundational, however, never activated. These have been unprecedented times with longer than anticipated stay at home and work from home requirements resulting in bigger and deeper adjustments to many more processes than previously anticipated under emergency conditions.

As organizations return to traditional work sites, the effectiveness of procedures for ongoing, remote reporting and recordkeeping should be evaluated and likely enhanced. As operations ramp-back up, the accuracy of records and supporting documentation during the current periods of remote operation should be tested. Organizations will likely need to provide regulators robust documentation for any system outages and incidents of incomplete reporting. Organizations should also be prepared to handle regulators' requests from cross-functional resources within their respective businesses. Additional support will likely be needed to clear the backlog of reporting requirements as new processes are being developed based on lessons learned.

When it comes to monitoring and surveillance, timely and efficient communication and data capture is key.

Companies should reevaluate their procedures and tools to assess their performance during the last several months. They should, as part of that exercise, consider whether the timeliness and accuracy of the communications and data capture are sound. Clear communication and accurate documentation for incidents and exceptions may ease the potential burden of regulatory inquiries should they come your way.

Finally, companies should develop responsible plans for reintroduction. They may need to evaluate how temporary adjustments in practices are best incorporated into core policies and procedures. Companies made changes to policies and procedures with the objective of staying in business.

As a result, companies should:

- Evaluate how existing policies and procedures for compliance performed through the remote setting and where gaps in frameworks should be addressed;
- Recognize “lessons learned” from technological challenges and limitations to support remote activity from a recordkeeping, transactional, and compliance governance perspectives; and
- Identify a path for upgrading and expanding technological capabilities, if warranted.

Such enhancements will likely need to become integrated as a permanent part of a company’s business continuity plans and trading policies and procedures creating an opportunity for a more resilient and compliant trading function. These improvements to operating plans will help increase preparedness in anticipation of the next potential global crisis.

Let’s talk.

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