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EFFECTIVE COMPLIANCE OVERSIGHT OF ENERGY COMMODITY TRADING IN A REMOTE TRADING ENVIRONMENT

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Following the declaration of a global pandemic due to the widespread transmission of the coronavirus (COVID-19), the issuance of shutdown and/or stay-at-home directives cascaded from commercial enterprises and state and local governments across the United States. During this period of extreme disruption to daily routine, the continuity and integrity of energy operations were necessary to ensure that the massive shift to home-based life could exist with minimal business disruption. Front- and back-office personnel engaged in trading energy commodities quickly transitioned to a work-from-home (WFH) posture, ensuring that their firms could preserve market access for production or output while also consummating the transactions needed to procure an adequate fuel source, managing price exposure to highly volatile commodity prices, or executing preexisting trading strategies.

Although the various shutdown and stay-at-home orders are expiring or easing in applicability, we expect many personnel to remain in a WFH environment for the foreseeable future. As we anticipate a world in which businesses operate in fundamentally new and different ways and individuals engage in a prolonged WFH environment for one or more days per week, it is essential that energy compliance, legal, and risk management personnel draw on lessons learned since the onset of COVID-19 and adapt existing compliance programs or oversight to the new normal.

MAINTAINING AN EFFECTIVE COMPLIANCE PROGRAM

Energy commodity regulators take the position that there is not a "one size fits all" approach to a compliance program or effective compliance oversight. Rather, a compliance program should be specifically tailored to the needs and trading activities of a market participant. Energy traders and their employers know all too well the importance of maintaining a robust and strong compliance program. A robust compliance program ensures that company risk management protocols are maintained. That program should ensure that traders undertake only lawful trading strategies and that compliance personnel promptly identify and investigate potentially problematic trading strategies. At bottom, a strong compliance program provides traders and other company personnel with the tools required to maximize benefit to the company while minimizing risk exposure.

Existing compliance programs or compliance oversight mechanisms are almost entirely premised on a paradigm whereby front- and back-office trading personnel are often (or exclusively) working from a company campus while connected to secure company technology and IT networks and compliance personnel have in-person access to such trading staff. However, that assumption may no longer be valid as we contemplate a prolonged WFH trading environment. Instead, certain issues arise that compliance, legal, and risk management personnel should consider while assessing whether existing compliance programs are well suited to facilitate commercial needs while mitigating the unique regulatory risk that is presented from a WFH environment.

In particular, company compliance personnel should take care to view existing compliance policies or protocols with a fresh eye and perform a "gap analysis", analyzing whether they are effective or appropriate for a prolonged WFH trading environment. To ensure that existing energy trading compliance programs remain effective or are adapted properly to suit a WFH posture, compliance personnel should consider, at a minimum, the following five issues:

- Whether compliance and legal personnel are regularly interfacing with commodity traders, risk management committees, and back-office personnel to remain abreast of existing (and anticipated) company trading strategies, products, and locations

- Reassessing existing compliance "hotline" technology or similar tools designed to provide a forum for personnel to raise questions or compliance-related issues and continue to make available sufficient avenues to personnel in a WFH environment
- Whether existing policies and procedures require modification to facilitate WFH trading or transaction execution
- How to implement and maintain interactive and effective ongoing training modules or programs for front-office personnel to demonstrate a robust trading compliance program
- How to timely follow up on any alert for potential noncompliance that may arise in the normal course of transaction oversight/monitoring

To the extent that compliance personnel determine that changes are required to an existing compliance program to address these issues, it is important that such changes be made and documented as soon as practicable. Further, it is important that compliance personnel regularly reassess existing compliance programs or practices to confirm that they are appropriately tailored to the evolving WFH environment.

KEY CONSIDERATIONS FOR EFFECTIVE ENERGY TRADING COMPLIANCE

A compliance program is "effective" only to the extent that it is suited to facilitate lawful energy trading and minimize potential instances of noncompliant energy trading. Below, we identify seven issues that company compliance, risk management, and legal personnel should consider with respect to interactions with front-office trading personnel and the transactions that those personnel undertake.

Effective Supervision of Trading Personnel

A firm's trading personnel must continue to be subject to adequate supervision while they work from home. A firm should document all commodity trading decisions made during the WFH environment, and should update existing supervisory policies and procedures to reflect how supervisory responsibilities will be modified to ensure that they are performed in the new WFH environment.

Generally, supervisory policies and procedures identify the following:

- Specific individual(s) responsible for each review
- Supervisory activities such persons will perform
- Frequency of the review
- Manner of documentation

A firm's supervisory policies and procedures should be updated to reflect changes to these general policies, including identifying the backup personnel responsible for performing these tasks if a person becomes sick, cannot work at full capacity because of childcare limitations, or must care for a sick family member. In the event that trading personnel are subject to special or heightened supervision, the firm should consider how such supervision can be undertaken in a WFH environment. A firm might consider excluding from eligibility, or placing conditions on, individuals subject to special or heightened supervision.

Training

Supervisors must consider how they will continue to train trading personnel while supervisory or trading personnel (or both) are working from home. For example, how will supervisory personnel effectively communicate relevant information in a rapidly changing environment? Supervisors must notify trading personnel about issues such as short-selling bans, position limits, and new or different reporting requirements, and must continue to provide ongoing training.

Monitoring

As discussed further below, supervisors are not able to "walk the trading floor" to monitor trading activities during a WFH situation. However, supervisors should schedule meetings or "check-ins" with their supervised personnel. In addition, supervisors should more frequently review trading personnel email correspondence and instant messages. Supervisors should also continue to monitor for insider trading, especially in the WFH situation where family members may have access to material, nonpublic information, which an employee could use to facilitate trading.

New Technologies

The increased use of videoconferencing and other collaboration platforms might necessitate modifications to a firm's policies, procedures, and IT infrastructure to ensure that the firm can continue to comply with applicable communications oversight and recordkeeping requirements. Supervisors should consider whether trading personnel may use Skype video, Zoom, or Webex, and how the supervisors can monitor these communications and, to the extent necessary, retain records of these communications. Additional internet bandwidth might be needed, and a firm should consider whether trading personnel, supervisors, or other critical functions need dedicated internet service.

Recordkeeping

As described in greater detail below, maintenance of recordkeeping is critical during a WFH mode. A firm's decisions should be documented to demonstrate its compliance with supervisory policies and procedures and how the firm tailored these policies and procedures to a WFH environment. If phone lines are no longer recorded, trading personnel should create and keep a written log of phone conversations (as well as the trading records generated for transactions) that would otherwise be subject to audio recordkeeping requirements.

Testing

Supervisory personnel should test the firm's supervisory protocols or processes to assess their effectiveness and make modifications to supervisory policies and procedures as necessary. Testing is especially critical in developing a supervisory structure with robust oversight that applies consistent controls whether the individual is sitting in firm headquarters or at a WFH location.

Compliance Access to Traders and the Trading 'Floor'

Federal energy regulators have indicated in multiple instances a view that compliance personnel should have direct and ready access to commodity traders. Such access may include the following:

- Access to a trading floor and the flexibility to "walk" the floor
- Constant and uninterrupted visibility and accessibility to trading personnel throughout the course of a trading day
- A mechanism to review potential transactions or strategies in near real time in order provide compliance perspectives to front-office personnel during the course of a trading day

The types of access that were customary and expected prior to the COVID-19 pandemic are now rendered difficult or impossible. Compliance personnel working remotely cannot have direct and physical access to commodity traders that are executing their functions in a remote environment. And, in an environment where trading desks and compliance personnel return to a corporate office, social distancing recommendations and best practices are expected to similarly make physical access between compliance personnel and traders challenging. For example, company social distancing policies may make it difficult or impossible for compliance personnel to "walk the floor." Likewise, a compliance officer or advisor would not be as readily able to look over the shoulder of a trader at his or her screen while discussing a potential strategy or how to react to potential bids and offers.

Employers should consider developing effective procedures and mechanisms so traders and compliance personnel have direct line access to one another. Such mechanisms can include the following:

- Ensuring that all front-office and compliance personnel have access to up-to-date land-line, cellular phone and instant messaging contact information
- Implementing a requirement for a daily compliance check-in between compliance personnel and traders at the end of the trading day to address any issues arising during that day or convey compliance-related developments to traders for the purpose of continuous training
- Considering whether to develop a practice whereby compliance personnel conduct a daily brief consult with traders individually to discuss any issues that either a trader or a compliance officer may want to raise
- Developing a regular "compliance minute" electronic distribution for traders where compliance personnel share relevant compliance-related information to recipients

Compliance with Applicable Recordkeeping Requirements

Compliance and legal personnel should consider the extent to which traders and middle-office employees are able to ensure the integrity of company recordkeeping protocols so that applicable recordkeeping obligations are satisfied. Both the Federal Energy Regulatory Commission (FERC) and the US Commodity Futures Trading Commission (CFTC) impose certain recordkeeping obligations on numerous types of records related to physical and derivative commodity trading as well as transmission and transportation-related asset optimization. Examples may include (but are not limited to) the following:

- FERC books and records obligations imposed on holding companies of regulated FERC utilities
- Retention requirements to which transmission providers must adhere to ensure compliance with FERC's Part 358 Standards of Conduct
- Recordkeeping practices to demonstrate compliance with FERC natural gas secondary market and shipper-must-have title regulations
- CFTC recordkeeping obligations imposed on traders in connection with futures and swaps, and related cash or forward, transactions
- CFTC recordkeeping applicable to nonfinancial entity end users relating to records that are necessary to demonstrate entitlement to the end-user exception and the inter-affiliate exemption from certain Dodd-Frank Act obligations

In a remote trading environment, traders that engage in physical and derivative transactions as well as asset optimization transactions potentially generate records outside of company file management systems. This may include circumstances where a trader or employee who is no longer working from his or her office while automatically connected to an employer computer network is instead performing work-related functions on a personal laptop or personal cell phone, outside of a company VPN, or utilizing personal email. In instances where such records are covered by existing recordkeeping or record retention obligations, it is critical that the creator or custodian of those records be aware of applicable obligations and promptly confirm that the records are transferred to company recordkeeping systems.

A remote trading environment can be, for many companies in the energy industry, an environment for which recordkeeping protocols are not well suited. In many instances, recordkeeping policies and protocols are designed with an assumption that trading, scheduling, and transaction consummations occur in a company office and on company network drives or through company telecommunications equipment. Compliance and legal personnel should review and assess existing protocols to determine whether they rely on such an assumption.

Preserving the Integrity of an Audit Trail

A key consideration for compliance and legal personnel assessing their company's commodity trading compliance readiness concerns the ability to respond to regulatory inquiries. Both FERC's and the CFTC's respective enforcement offices and divisions continue to pursue their investigative and auditing missions. As a result, companies should be prepared to respond in a timely and effective manner when contacted by a regulator.

An environment in which front-office (and back-office) personnel are engaged in their duties remotely raises unique issues and challenges that must be resolved to ensure that the integrity of a company's response to regulator inquiry is preserved. Such issues include the following:

- Whether company personnel are permitted to use personal telephones for trade negotiation, execution, and/or posting of bids and offers
- Whether use of noncompany instant messaging platforms is permitted for trade negotiation, execution, and/or posting of bids and offers
- Whether traders working remotely can adhere to company policies requiring the recording of voice recordings or instant message chats
- How or whether companies are able to memorialize or review for compliance purposes the substance of trader communications that are not recorded or otherwise documented in real time
- Ensuring that documentation and data necessary to respond to a regulatory inquiry are able to be collected within specified timeframes

Although neither FERC nor the CFTC mandate a particular approach for a successful compliance plan, both agencies do expect that companies can and will produce accurate and complete data upon request in the course of either an investigation or an audit. Companies must give careful thought to these issues to ascertain whether and how company policies require revision, or whether modifications to trading practices are prudent to ensure the integrity of an audit trail.

Electronic Security of Trading Systems and Data

Increased remote accessibility to company information and trading systems and the possibility that a remote working environment may exist for a sustained period of time for many personnel present certain risks related to the security of trading systems and data. Often, the tools and systems deployed for residential use are less secure than the hardware and related tools used to implement corporate networks. These risks relate to, among other things, the wireless routers, modems, or even electronic hardware used to provide residential access.

For example, home networking software may not reflect the most current security updates or patches that exist. In contrast, corporate networks and corporate IT departments are often diligent in ensuring that onsite systems reflect the most up-to-date security updates. In instances where residential networking tools are outdated, it becomes possible to exploit the security hole and compromise the activities of the residential user. Relatedly, in instances where phishing activities are targeted to other members of an employee's household, those activities can be used as a tool to access and exploit company information. It is important that compliance personnel and company legal counsel consider these risks in preparation for a prolonged remote working environment.

Preserving Confidentiality

For commodity traders working from home, it is imperative that employers pay special attention to protect and maintain the security and confidential nature of materials that warrant confidential treatment. This may include, for example, customer information, trade secrets, and transaction-specific sensitive information such as price, volume, and the identification of counterparties.

Both front- and back-office personnel often have access to sensitive and confidential information in the normal course of conducting their day-to-day transaction and trading-related functions. However, as employees work in a remote environment and access company networks from remote locations beyond the company campus, a risk emerges that confidential information may be released, shared, or otherwise dispersed inadvertently. If employers do not take proper steps to protect sensitive or confidential information, those employers may be limited in claiming confidential treatment or a Freedom of Information Act exemption in a subsequent regulatory investigation or civil action.

As a result, compliance and legal personnel should review existing practices and systems to assess whether appropriate measures exist to preserve and maintain the confidential nature of sensitive information. To that end, employers may also consider implementing policies designed to address this risk posed by a remote working environment. Such policies might include the following:

- Ensuring that traders and back-office personnel have access to secure electronic file management systems
- Documenting company policies requiring personnel who access confidential information to do so only while on company secure networks to the extent practicable
- Requiring personnel to store confidential information on a secure document management system within a defined period of time of receiving or handling the information if such receipt or handling occurred on an unsecured noncompany network
- Documenting instructions on storing or transferring confidential information and company records if such storage or transfer cannot readily occur on a company network within a stated period of time

Shifting a company's workforce to operate almost entirely with remote access may increase risks to the company's confidential information. Proactive steps that anticipate a prolonged remote working environment can assist in ensuring that confidences are not compromised.

Potential for Insider Trading

Federal regulators take seriously actual or alleged occurrences of insider trading. Circumstances where commodity trading transactions are undertaken in a remote environment create an elevated risk that insider trading might occur. Further, revisions to the Commodity Exchange Act following enactment of the Dodd-Frank Act mean that the prohibition on insider trading directly applies to CFTC-regulated markets. Put another way, insider trading of futures, derivatives, or similar commodities is prohibited. In 2018, the CFTC formed an insider trading task force and efforts are continuously ongoing to identify and investigate potential instances of insider trading.

At its core, an act of insider trading in violation of CFTC regulations is a fraud-based offense that concerns trading on the basis of material nonpublic information that was obtained in breach of a duty or via deception. Many companies have implemented compliance controls to prevent or proactively detect potential instances of insider trading. Notwithstanding those efforts, novel risks exist for instances of insider trading in a remote trading environment. For example, the CFTC's relaxation of voice recording requirements for some regulated entities following the onset of COVID-19 could make it difficult for company compliance personnel to detect and prevent against potential insider trading that was facilitated on the non-recorded lines. Likewise, government actions to ease COVID-19-related commercial impacts (such as legislative or related regulatory relief) creates new sources from which trading personnel could access material non-public information.

In some instances, there may be an elevated potential to receive material nonpublic information that qualifies as "inside information." Routines and established patterns of behavior have been upended as personnel transitioned to and are operating from a remote trading posture. As part of that disarray, information may be obtained from new sources, thereby creating a risk that the new source is unaccustomed to handling the nonpublic price-sensitive information. In addition, company insider trading controls may be either strained or ill equipped to function properly.

To address these potential risks, company compliance officers should give due consideration to whether existing insider trading controls can be effective in policing potential areas of noncompliance of improper behavior—including inadvertent behavior. Now is a good opportunity for compliance personnel to consider whether new trading strategies are being properly vetted, whether existing policies properly address all sources of information, and whether communications controls are sufficient. Further, companies should be careful to ensure that personnel are properly trained in the prohibition against insider trading and that compliance concern portals are fully accessible to individuals who may have concerns to raise.

RESPONDING TO A REGULATORY INQUIRY

Effective compliance also requires that a company interface with regulators and respond to regulatory inquiries in an effective, efficient, and timely manner. Notwithstanding the onset of the COVID-19 pandemic, both FERC and the CFTC continue to initiate audits and investigations. For example, the CFTC has publicly announced an industrywide inquiry into the causes and actions relating to the volatile WTI May futures contract price that occurred in April 2020.

Despite all best efforts to maintain strong and robust compliance practices, it is possible that any energy market participant could receive an inquiry from a regulator regarding energy commodity trading activity. In preparing to respond to a regulatory inquiry, compliance and legal personnel should give due consideration to the following issues that arise due to a transition to a WFH environment:

- How to properly and effectively coordinate preparation of data responses between various personnel working remotely from one another
- The efforts and precise steps that are required to identify all custodians of materials that are potentially responsive to data requests
- How to effectively collect all responsive materials from identified custodians, including materials that may have been created on off-network systems or personal telecommunications equipment
- A realistic assessment of the timing required to provide a full and complete data response
- How to make personnel available to provide responses to regulator questions
- How to ensure that legal counsel is able to effectively accompany nonlegal personnel in any interactions with regulators conducting an audit or inquiry

CONCLUSION

Despite the initial challenges of transitioning to a WFH environment, companies will need to remain diligent in tailoring relevant policies and procedures to apply to a prolonged WFH situation. This is especially true in light of the fact that regulatory agencies have not hit "pause" on their oversight functions during COVID-19—and will expect companies to have hit their stride in performing their compliance obligations in the new normal.

COMPLIANCE CONSIDERATIONS

Maintaining an Effective Program

- ☐ Compliance and legal personnel are interfacing with commodity traders regularly (i.e., daily or weekly).
- ☐ Compliance and legal personnel are remaining knowledgeable and "plugged in" to company trading strategies, products, and locations.
- ☐ Confirm remote trading personnel have seamless and readily available access to avenues that allow for reporting of compliance concerns or raising of compliance questions.
- ☐ Evaluate whether existing policies or procedures need to be modified to permit remote trading.
- ☐ Verify that a robust and effective mechanism is in place to follow up on any potential compliance alerts raised during the ordinary course of oversight.

Facilitating Remote Trading Compliance

- ☐ Document all commodity trading decisions made during the WFH phase.
- ☐ Update supervisory policies and procedures to reflect changes as a result of the new WFH environment.
- ☐ Implement and maintain interactive and effective training modules or programs for office personnel.
- ☐ Supervisors are effectively communicating relevant and current information to trading personnel.
- ☐ Supervisors are scheduling meetings or "check-ins" with their personnel.
- ☐ Supervisors are reviewing trading personnel email communications and instant messages more frequently and are monitoring for insider trading.
- ☐ Evaluate whether policies, procedures, and IT infrastructure need to be modified to maintain compliance with communications oversight and recordkeeping requirements if videoconferencing and other collaboration platforms are used.
- ☐ If trading personnel are permitted to use videoconferencing and other collaboration platforms, supervisors are monitoring these communications, and to the extent necessary, retaining records of these communications.
- ☐ Document decisions related to recordkeeping to demonstrate compliance with supervisory policies and procedures and explain how the policies and procedures were tailored to a WFH environment.
- ☐ If phone lines are no longer being recorded, trading personnel are keeping records of phone conversations that would otherwise be subject to recordkeeping requirements.
- ☐ Supervisors are testing the supervisory protocols or processes to assess their effectiveness or make modifications as necessary.

Compliance Access to Traders and the Trading 'Floor'

- ☐ Develop procedures and mechanisms so traders and compliance personnel have direct line access to one another.

Recordkeeping Requirements

- ☐ Compliance and legal personnel are considering the extent to which traders and middle-office employees are able to ensure the integrity of recordkeeping protocols.
- ☐ Confirm that all records, including those generated outside of company file management systems, are transferred to company recordkeeping systems.
- ☐ Compliance and legal personnel are reviewing and assessing protocols to determine whether they are designed with an assumption that trading, scheduling, and transaction consummations occur in a company office, on company network drives, or through company telecommunications equipment.

Electronic Security of Trading Systems and Data

- ☐ Compliance and legal personnel are considering security risks arising in preparation for a prolonged remote working environment.

Preserving Confidentiality

- ☐ Compliance and legal personnel are considering existing practices and systems to assess whether appropriate measures exist to preserve and maintain the confidential nature of sensitive information in a prolonged remote working environment.
- ☐ Compliance and legal personnel are considering implementing policies to address confidentiality risks posed by a remote working environment.

Potential for Insider Trading

- ☐ Compliance personnel are considering whether existing insider trading controls are effective in policing potential areas of noncompliance or improper behavior—including advertent behavior.
- ☐ Ensure personnel are properly trained in the prohibition against insider trading and that compliance concern portals are fully accessible to individuals with concerns to raise.

Responding to Regulatory Inquiries

- ☐ Ensure that the company is able to respond to regulatory inquiries and can produce accurate and complete data upon request in an investigation or an audit.

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