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CFTC Orders The Options Clearing Corporation to Pay a \$5 Million Penalty for Violations of Core Principles and Regulations Related to Operational Risk Management

Second CFTC Action for Core Principle Violations

February 16, 2023

Washington, D.C. — The Commodity Futures Trading Commission today issued an order simultaneously filing and settling charges against The Options Clearing Corporation (OCC), a Chicago-based CFTC-registered derivatives clearing organization (DCO). The order finds the respondent failed to establish, implement, maintain and enforce certain policies and procedures reasonably designed to manage the operational risks related to its automated systems in violation of the Commodity Exchange Act (CEA) and related CFTC regulations.

Without admitting or denying the CFTC's findings, OCC agreed to pay a \$5 million penalty for violations of the CEA and CFTC regulations and be subject to undertakings relating to remediation.

"DCOs play a critical role in U.S. futures and options markets and the CFTC requires full compliance with the DCO Core Principles," said CFTC Acting Director of Enforcement Gretchen Lowe. "Today's action shows that to fully comply with the Principles, DCOs must not only establish policies and procedures designed to manage their risks, but also implement, maintain, and enforce those policies and procedures."

Case Background

The order finds that from October 2019 through May 17, 2021, OCC failed to comply with DCO Core Principles

(https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_12_DCMRules/index.htm) to establish, implement, maintain and enforce certain policies and procedures reasonably designed to manage its operational risks by identifying the plausible sources of operational risk and mitigating their impact through the use of appropriate systems, policies, procedures, and controls. Specifically, to address the impact of certain transaction-based costs associated with the cost of liquidating a Clearing Member's portfolio, OCC implemented an add-on charge to better account for the cost of liquidating a defaulting Clearing Member's portfolio (the "LC Charge") in its STANS methodology used to calculate margin. However, OCC failed to make a corresponding change to incorporate the LC Charge in its Clearing Fund calculation in violation of OCC's Comprehensive Stress Testing and Clearing Fund Methodology, and Liquidity Risk Management Description, which is an OCC rule.

As a result of deficiencies in certain internal controls, human errors, and oversight failures, OCC's Clearing Fund was underfunded by between \$200 million to \$588 million at various times during October 2019 through May 17, 2021. OCC represents that, notwithstanding the underfunding, OCC's Clearing Fund maintained sufficient financial resources to meet its obligations in the event of a default by the single member or participant creating the largest financial exposure in extreme but plausible market conditions, in accordance with CFTC requirements. Nonetheless, the order finds, OCC's failures violated two DCO Core Principles and related implementing CFTC Regulations 7 U.S.C. § 7a-l(c)(2)(H), (I); 17 C.F.R. §§ 39.17(a)(1), 39.18(b)(l), (2) (2022).

In September 2019, the CFTC instituted an action against OCC, which ordered OCC to cease and desist from committing or causing any violations and any future violations of certain DCO Core Principles and related CFTC regulations. [See CFTC Press Release No. 8000-19 (<https://www.cftc.gov/PressRoom/PressReleases/8000-19>)] This order included one Principle requiring system safeguards to identify and minimize sources of operational risk and the related CFTC regulation, and undertakings requiring that OCC establish and implement internal controls, and policies and procedures reasonably designed to comply with DCO Core Principles and the Regulations. The order states that, while the violations identified in this order differ in nature and scope, the CFTC notes its concern that OCC's failure to implement certain of its policies and procedures related to the LC Charge occurred after the 2019 order.

In accepting the respondent's offer, the CFTC recognizes OCC's cooperation with the Division of Enforcement's investigation of this matter. The CFTC also acknowledges the respondent's representations concerning its remediation. The CFTC's recognition of the respondent's cooperation and appropriate remediation is further reflected in the form of a reduced penalty.

Parallel Civil Enforcement Action

In a parallel action, the Securities and Exchange Commission (SEC) today issued an order resolving OCC's violations of their rules.

The CFTC appreciates the assistance of the SEC.

The Division of Enforcement staff responsible for this matter are Allison Passman, Scott Williamson, and Robert Howell. August Imhoff, Theodore Polley, and Julie Mohr of the Division of Clearing and Risk also assisted in this matter.

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