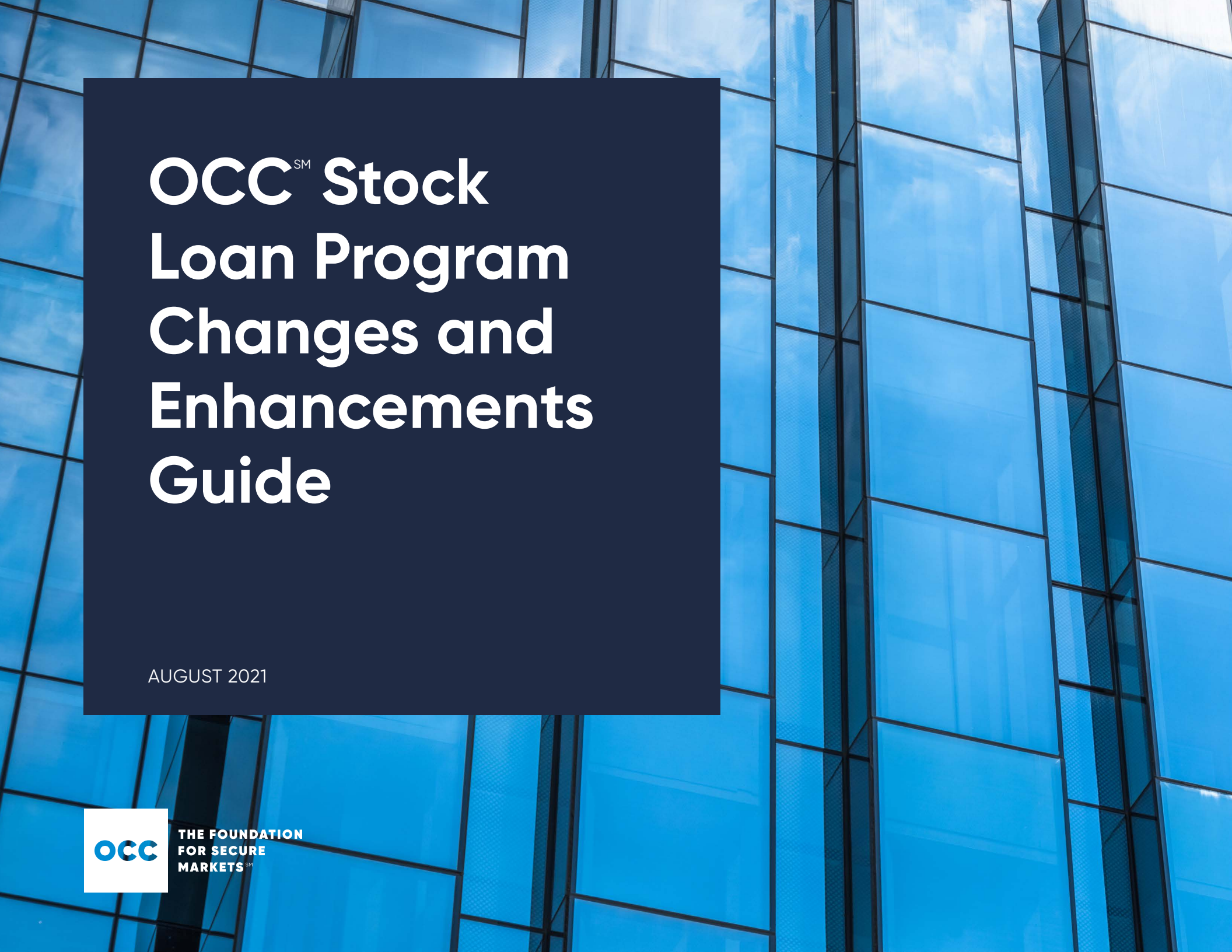

OCC℠ Stock Loan Program Changes and Enhancements Guide

AUGUST 2021

OCC

THE FOUNDATION FOR SECURE MARKETS℠

This document identifies the changes, enhancements and transaction workflows to both the Hedge and Market Loan Programs as part of the Renaissance Initiative, pending regulatory approval.

At launch of the new platform, OCC will support both Hedge and Market Loan Programs. Soon after the launch of the new platform, Hedge will be decommissioned and will migrate to the enhanced Market Loan Program.

This migration will allow OCC to maintain a single Stock Loan Program, capable of handling both bilaterally negotiated stock loans and stock loans matched through a loan market.

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Questions?

Please contact:
OCCPlatformTransition@theocc.com

Stock Loan Programs

Currently, OCC operates two distinct Stock Loan Programs: Stock Loan, also referred to as Hedge, and Market Loan. To be able to expand the stock loan product and service offerings further, we will first enhance our Market Loan Program at the launch of the new platform.

As mentioned, OCC will make changes to the Hedge program, which will be supported for approximately one year after the launch of the Renaissance Initiative. Please note, OCC will require testing with Clearing Members and third-party service providers to support the changes.

Hedge Program

Stock loan contracts are executed bilaterally between counterparties under the current rules and system. The contracts settle at the U.S. equities depository and OCC is subsequently advised of the transactions to novate.

Upon acceptance, OCC, in acting as a central counterparty, guarantees the value of lent shares.

Payments in lieu of cash dividends are generally affected through the depository but are subject to a limited guaranty by OCC. If the Borrower and Lender are OCC Clearing Members that have elected to clear the stock loan, OCC is substituted as the central counterparty after initial settlement at the depository.

Market Loan Program

In the Market Loan Program, lending and borrowing Clearing Members currently submit their orders to Equilend Clearing Services' (ECS) electronic trading platform, also known as a loan market.

The loan market transmits resulting matched loans to OCC, which are validated by OCC and are then sent to the depository with settlement instructions. Following submission to the depository, the loaned stock is transferred to the Borrower against the payment of cash collateral to the Lender.

Upon acceptance, OCC, in acting as a central counterparty, guarantees the value of lent shares. In addition to these guarantees, OCC also guarantees payments in lieu of cash dividends and rebates, which are paid through OCC's cash settlement system.

Changes to OCC's Stock Loan Programs are subject to regulatory approval. A more detailed discussion, including any changes to the enhancements discussed herein, will be available in forthcoming regulatory filings.

Hedge Program Changes

Until the launch of Renaissance, the Hedge Program will continue to support the existing workflow through the depository until its ultimate migration and decommission. However, there will be two changes within the new system:

Account Maintenance

The entry of Default Lending Collateral Percentages and Mark Price rounding and counterparty approval will be entered by Clearing Members through a user interface. This will eliminate physical forms and make the process more efficient.

Contract-Level Accounting

OCC's current stock loan system, ENCORE, aggregates new loans for the same counterparties and the same security into positions.

For example, a new loan for Lender ABC and Borrower XYZ for a given security would create a position. Any subsequent new loans for the same security between Lender ABC and Borrower XYZ would increase the quantity on this position. Similarly, returns decrement the quantity of outstanding shares on these positions.

The current aggregation process will be enhanced with Renaissance so that each new loan will create a contract, and returns and buy-ins will reduce the contract quantity. This means aggregation of contracts with the same Lender and Borrower for the same security will no longer be done.

The additional data elements that describe stock loan contracts (e.g. rebate rate and term date) will not be present on Hedge contracts since that information is not provided to OCC from the depository.

Changes to OCC's Stock Loan Programs are subject to regulatory approval. A more detailed discussion, including any changes to the enhancements discussed herein, will be available in forthcoming regulatory filings.

Hedge New Loan Workflow

OCC will continue to support the existing workflow through the depository where Clearing Members submit delivery orders using the depository Reason Code 260 for OCC to clear the new loans. Upon acceptance of the stock loan transaction, OCC will record the loan in the new system.

Going forward, each new loan that is recorded will generate a contract between the Lender and Borrower for the number of shares lent.

OCC will no longer aggregate contracts with the same combination of Lender, Borrower and security into positions. Instead, OCC will mark-to-market (MTM) each contract every evening. This will then be netted and included in the standard next day settlement.

1

Lender and Borrower negotiate a new loan through a trading platform

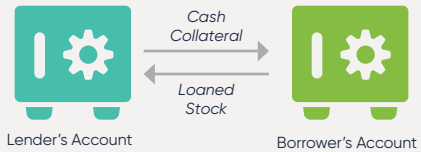
2

Lender submits delivery order to the depository using reason code 260

3

Borrower approves the receive at the depository

4



The depository transfers loaned stock vs. cash collateral

5

The depository notifies OCC of the settled transaction

6

Upon confirmation of settlement, OCC guarantees the contract.

Hedge Returns Workflow

OCC will continue to support the existing workflow through the depository where Clearing Members currently submit returns to the depository using the Reason Code 270. Upon settlement of the return, OCC will reduce the open Hedge contracts starting with the oldest contracts first.

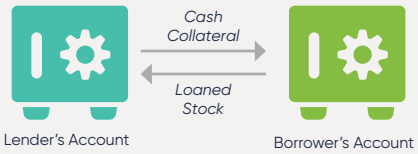
1

Borrower instructs the depository to transfer the loaned shares being returned vs. cash collateral

2

Lender authorizes the receive at the depository

3



The depository settles stock vs cash

4

The depository notifies OCC of the settlement

5

Upon confirmation of settlement, OCC reduces the open contracts beginning with the oldest contract first.

Lender Borrower

Hedge Buy-Ins Workflow

Buy-Ins will continue to be managed independently and then must be entered into the stock loan system. Upon replacement of the shares or collateral, OCC will mark the contract to settle any outstanding obligations and reduce the oldest contracts first.

1

Lender notifies Borrower of the quantity of shares they intend to buy-in

2

After executing the buy orders, the Lender notifies OCC and Borrower of the quantity bought-in, the price paid, and any associated fees

3

Borrower approves buy-in at OCC

4

Upon acceptance by the Borrower, OCC will reduce the contract(s) beginning with the oldest first

5

The difference between the contract value and the buy-in settlement value will be settled the following morning by 10 a.m. EST.

Changes to OCC's Stock Loan Programs are subject to regulatory approval. A more detailed discussion, including any changes to the enhancements discussed herein, will be available in forthcoming regulatory filings.

Market Loan Enhancements

In response to requests from industry participants for expanded product and service offerings, OCC will enhance the Market Loan Program to develop a foundation upon which we can deliver future clearing innovations. As mentioned, OCC will make changes to the current program to support the current ECS workflow along with adding new functionality to support bilaterally negotiated loans that did not originate through ECS. Below further details the new enhancements and functionality that will be added to the program:

Improved Trade Interface

OCC currently accepts electronic messages from loan markets for new loans and returns. The improved trade interface would continue to accept messages from the loan market but would expand to also accept submissions directly by Clearing Members (or their third-party service providers). This would allow for automated submission of transactions to OCC prior to the depository settlement and reduce the operational overhead and risk associated with errors.

Transaction Affirmation

For transactions that were not electronically matched by ECS, OCC will require the counterparties to affirm that the transaction details are correct prior to the transaction being processed. This affirmation will be required for new loans and re-rates. Affirmation can happen in three different ways: (1) both the Lender and Borrower (or their third-party service provider) submit matching instructions to OCC, (2) following the submission by one side, the counterparty explicitly affirms via a message or a screen, or (3) members may establish standing automatic affirmation rules, which will automatically affirm transactions that meet their affirmation rules. OCC's new system will pend returns and buy-ins to allow the counterparty to affirm or reject the transactions. If the counterparty has not taken any action prior to the end of the day processing, OCC will automatically affirm the transaction. This process is designed to allow the Lenders an opportunity to accept or reject, but transactions would still be sent for settlement if the Lender fails to respond. Recalls will be automatically accepted. The goal of affirming transactions is to reduce the number of discrepancies by identifying differences prior to the transaction occurring.

Delivery of Stock vs. Collateral

Following the affirmation of a new loan or return, OCC will instruct the depository to settle the transaction using OCC's depository account as a pass-through. By controlling the settlement, OCC will help reduce many of the discrepancies that currently occur within OCC's Hedge Program.

Anonymous vs. Disclosed

When the Market Loan Program was created, all transactions were electronically matched and carried on an anonymous basis. Over time, the Market Loan platform began accepting bilaterally negotiated loans through a trade submission portal. Previously, OCC did not distinguish between anonymous and disclosed transactions and treated all positions as anonymous. Under the new system, OCC will distinguish anonymous from disclosed transactions and show both parties on disclosed contracts.

Contract-level Accounting

OCC's current stock loan system, ENCORE, separates each matched new loan into two transactions, each with OCC's account 982 as the counterparty. OCC then aggregates new loans for the same counterparties and the same security into positions. This means that for any Lender or Borrower all of their contracts in any given security are aggregated, even if the original counterparties were different. Similarly, returns decrement the quantity of outstanding shares on these positions. Under the new Market Loan Program, each new loan, return, and buy-in will be done at the contract level and aggregation will no longer take place. The additional data elements that describe stock loan contracts (e.g. rebate rate and term date) will be recorded at the contract level. Also, under the enhanced Market Loan Program, returns will reference the specific contract against which shares are being returned and the contract's quantity will be decremented upon settlement.

Changes to OCC's Stock Loan Programs are subject to regulatory approval. A more detailed discussion, including any changes to the enhancements discussed herein, will be available in forthcoming regulatory filings.

Additional Post-Trade Activity

OCC's current practice of aggregating contracts into positions means that certain post-trade activity must be performed within the loan market's system. An example of this activity is a re-rate transaction that changes the rebate rate on a contract. This same workflow must be followed for anonymous transactions matched by ECS. Changes to disclosed contracts may be done either through ECS or directly to OCC. The new stock loan system will accept and process contract updates including:

- **Contract Modifications** – transactions that change an aspect of a contract such as the rebate rate.
- **Recalls** – instructions by the Lender that a quantity of shares against one or more contracts must be returned by the Borrower within a specific period (typically two business days).

Canadian Clearing Members (CCMs)

Under OCC's revised rules CCMs will become eligible to participate in the Market Loan Program. However, there will be two restrictions due to tax considerations:

- In consideration of certain tax withholding concerns, OCC cannot allow a CCM that is not acting in their capacity as a Qualified Derivatives Dealer (QDD) to be the Lender on a loan with a negative rebate rate. Therefore, OCC will not accept new loans where the lending account is a CCM's firm account and the rebate rate is negative. Nor will OCC allow an existing loan in a CCM lending account to be re-rated to a negative rate.
- Additionally, OCC cannot allow CCMs from borrowing American Depository Receipt (ADRs) issued by Canadian based companies. Substitute dividends on these ADRs are subject to Canadian tax-withholding and therefore will not be allowed.

Account Maintenance

Anonymous positions will still be carried at 102% with mark prices rounded up to the next dollar. For disclosed positions, the Lender may elect to collateralize loans at 100% and specify a more precise rounding. The entry of Default Lending Collateral Percentages and Mark Price rounding and counterparty approval for disclosed positions will be entered by the Clearing Members through a user interface.

Counterparty Relationships Preserved

Similar to the Hedge Program, the original parties to bilaterally negotiated loans would remain paired in OCC's system, notwithstanding novation and counterparty substitution following a default by one of the original parties. Accordingly, returns and recalls, as well as any renegotiation of rebate rates will be between the original, or substituted in the case of a default, parties.

Enhanced Guarantee

In addition to guaranteeing against financial loss as a result of forced buy-ins and/or sell-outs (i.e. when a Clearing Member is suspended), OCC will also calculate, guarantee and settle rebate accruals and cash distributions.

Capital and Operational Efficiency

A single net payment to or from OCC for cash entitlements (rebate accruals and cash distributions) will become more operationally efficient versus individual payments among each counterparty. The net exposure with OCC will also require less regulatory capital versus bilateral exposures.

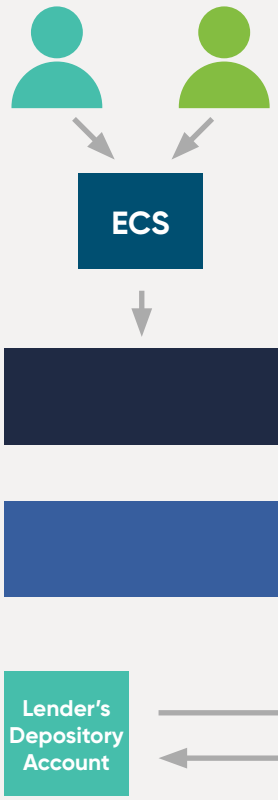
Changes to OCC's Stock Loan Programs are subject to regulatory approval. A more detailed discussion, including any changes to the enhancements discussed herein, will be available in forthcoming regulatory filings.

Enhanced Market Loan Workflow

As mentioned, the enhanced Market Loan Program will continue to accept transactions from ECS and it will extend this concept by allowing Clearing Members (or their third-party service providers) to directly submit transactions to OCC. Since bilateral transactions were not matched by a loan market, OCC will require affirmation of certain transactions by the counterparty prior to OCC processing the transaction.

Submit via a Loan Market

1. Lender and Borrower submit orders to lend and borrow a stock.
2. ECS matches the orders.
3. ECS submits the matched trade to OCC.
4. OCC validates the trade and sends delivery instructions to the depository.
5. The depository settles the loan by delivering shares vs. cash.



Direct Submission from Participants

1. Lender and Borrower submit details of a bilaterally negotiated loan.
2. OCC validates the trade and checks that the submitted terms agree.
3. OCC validates the trade and sends delivery instructions to the depository.
4. The depository settles the loan by delivering shares vs. cash.

Please note the distinctions listed for transactions submitted via a loan market compared to transactions submitted directly from participants.

Lender Borrower

Transactions Submitted via ECS

ECS — New Loan Workflow

Upon acceptance of the stock loan transaction from ECS, OCC will record the loan in the new stock loan system. Every new loan that is recorded will generate a contract between the Lender and Borrower for the number of shares lent. In the case of anonymous contracts, the counterparty information will be OCC.

Going forward, OCC will no longer aggregate contracts with the same combination of Lender, Borrower and security into positions. OCC will show the identity of the counterparty on disclosed positions. We will also continue to Mark-to-Market (MTM) each contract at the end of each day.

1

Lender provides ECS an offer to lend shares at a given rate

2

Borrower provides ECS with a bid to borrow shares at a given rate

3

ECS matches a Lender and Borrower at a price they both agree to

4

ECS notifies OCC of the matched new loan

5

OCC validates that the Lender and the Borrower are valid accounts, and that the security is eligible

6

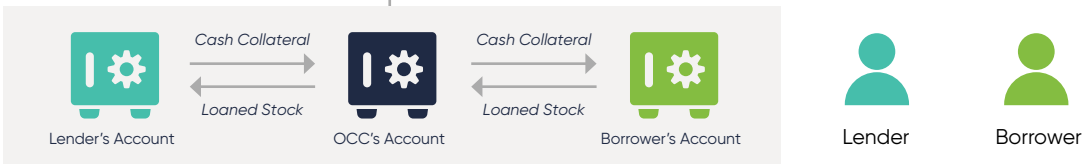
OCC sends DVP settlement instructions to the depository

7

The depository settles stock vs. cash

8

Upon confirmation of settlement, OCC guarantees the contract



ECS – Returns Workflow

As mentioned, OCC will continue to support the existing workflow from ECS. However, ECS will now identify which contract is being returned and OCC will decrement that contract once the return settles.

1

Borrower notifies ECS of the number of shares to be returned against a contract

2

ECS validates that the current contract quantity is equal to or greater than the return quantity

3

ECS notifies Lender of the return

4

ECS submits return to OCC

5

OCC performs validations

6

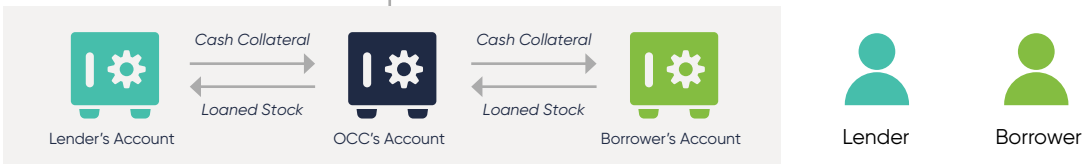
OCC sends DVP settlement instructions to the depository

7

The depository settles stock vs. cash

8

Upon confirmation of settlement, OCC reduces or closes the contract



Changes to OCC's Stock Loan Programs are subject to regulatory approval. A more detailed discussion, including any changes to the enhancements discussed herein, will be available in forthcoming regulatory filings.

ECS – Buy-Ins Workflow

Buy-Ins for anonymous contracts will continue to be managed independently, but must be provided by ECS to OCC. Disclosed contracts can be submitted through ECS or directly to OCC.

Upon replacement of the shares or collateral OCC will mark the contract to settle any outstanding obligations and then reduce the contracts that were bought in.

1

Lender notifies ECS of the quantity of shares they intend to buy-in against a given contract

2

ECS validates the quantity to be bought-in against outstanding recalls. If accepted, OCC will freeze that quantity of shares and potentially cancel any pending returns in order to avoid duplication via a return

3

ECS notifies Borrower of the impending buy-in

4

After executing the buy orders, the Lender notifies ECS of the quantity bought-in, the price paid, and any associated fees

5

ECS notifies Borrower of the quantity bought in, the price paid, and any fees

6

ECS notifies OCC of the buy-in including the quantity bought in, the price paid, and any fees

7

The difference between the contract value and the buy-in settlement value will be settled the following morning by 10 a.m. EST

Changes to OCC's Stock Loan Programs are subject to regulatory approval. A more detailed discussion, including any changes to the enhancements discussed herein, will be available in forthcoming regulatory filings.

Transactions Submitted via Participants

Bilateral New Loan Workflow

Following the negotiation of a new loan, Clearing Members will submit new loan instructions to OCC. Upon validation of the accounts and product, OCC will pend new loans until affirmation by the counterparty occurs. Once agreement on the new loan terms is confirmed by both the Lender and the Borrower, OCC will then instruct the depository to perform settlement of the loan securities vs. the collateral. OCC will support a number of ways that Clearing Members may affirm new loans. New loans that are not affirmed by the time that OCC stops accepting instructions at the end of each day will be rejected.

1

Lender and Borrower negotiate anew loan through a trading platform or other traditional method

2

Lender submits new loan instruction to OCC

3

OCC validates that the Lender and the Borrower are valid accounts, and that the security is eligible

4

Borrower affirms the new loan within OCC's system

5

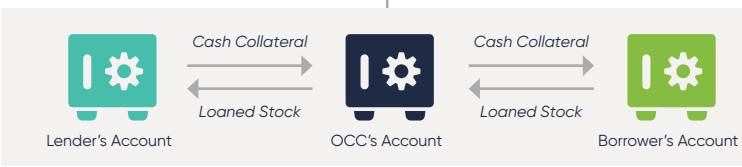
OCC sends DVP settlement instructions to the depository

6

The depository settles stock vs. cash through OCC's account

7

Upon confirmation of settlement, OCC guarantees the contract



Bilateral Returns Workflow

OCC will validate the returns that are submitted directly by borrowing Clearing Members. Return instructions must reference the correct contract and there must be sufficient open shares to return. Valid returns will be pended in order to allow the Lender an opportunity to affirm or reject the return. As mentioned, the Lender's affirmation could be completed through an electronic message, OCC's user interface or a standing automatic affirmation rule. Returns that are pending affirmation prior to the depository close at 2:15 p.m. CT will be automatically affirmed and submitted to the depository for processing.

1

Borrower provides return instructions for a specific contract to OCC

2

OCC validates that there are sufficient open shares on the contract

3

Borrower affirms the return within OCC's system

4

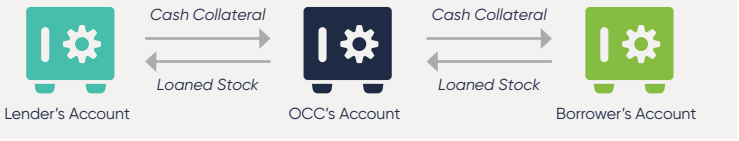
OCC sends DVP settlement instructions to the depository

5

The depository settles stock vs. cash through OCC's account

6

Upon confirmation of settlement, OCC reduces the contract by the quantity of shares returned



Lender

Borrower

Bilateral Recalls Workflow

When a lending Clearing Member requests to have shares returned, a recall instruction may be submitted against a specific contract. Recalls do not need to be affirmed by the borrowing Clearing Member. Instead, OCC will automatically note the recall quantity and date on the contract and notify the Borrower directly.

1

Lender notifies OCC of the quantity of shares to be recalled against a specific contract as well as the expected settlement date.

2

OCC validates that quantity to be recalled doesn't exceed the current contract quantity.

OCC applies the recall to the contract. Any subsequent returns will reduce the recall quantity. OCC will also validate any subsequent buy-ins to ensure the recall was not satisfied.

3

OCC notifies Borrower of recall.

Bilateral Contract Modifications (Re-Rates) Workflow

Either the lending or borrowing Clearing Member may propose a modification to the terms of a contract. As mentioned, these modifications must be affirmed by the counterparty via an electronic message, OCC's user interface or a standing automatic affirmation rule. Contract Modifications that are not affirmed by the time that OCC stops accepting instructions for the day will be rejected.

1

Lender or Borrower submit the change they wish to make against a specific contract

2

OCC validates that the contract modification instruction is valid and then notifies the counterparty that a change is pending their affirmation

3

The counterparty affirms the change to the contract

4

OCC makes the requested change to the contract

Lender Borrower

Bilateral Buy-Ins Workflow

If a Borrower fails to return shares as a result of a recall, then the Lender may choose to initiate a buy-in for the outstanding recall quantity. The first step in the new buy-in process is for the Lender to notify the Borrower and OCC of the quantity of shares that they intend to buy-in. Upon receiving and validating this buy-in initiation instruction, OCC will freeze that quantity of shares, including canceling any pending returns if necessary. Once the lending Clearing Member has purchased the replacement shares then they will finalize the buy-in by providing the quantity of shares purchased, the price paid for those shares and any additional fees associated with the buy-in. These terms of a buy-in will be presented to the Borrower for affirmation or rejection prior to being processed by OCC. Any valid buy-ins that are still pending affirmation thirty minutes before completion of processing for the day will be automatically processed by OCC. If the buy-in price is greater than the lowest price during the prior two trading days, and less than the greatest price over the prior two days, then the buy-in will be automatically affirmed and processed by OCC. This will ensure that buy-ins with reasonable prices are not held up due to inaction by the Borrower.

1

Lender initiates the buy-in by notifying OCC and the Borrower of the quantity of shares they intend to buy-in against a given contract

2

OCC validates the quantity to be bought-in against outstanding recalls. If accepted, OCC will freeze that quantity of shares and potentially cancel any pending returns in order to avoid duplication via a return

3

After executing the buy orders, the Lender finalizes the buy-in by notifying OCC of the quantity bought-in, the price paid, and any associated fees

4

OCC notifies the Borrower that there is a buy-in pending their affirmation.

5

Borrower may affirm or reject the buy-in

6

Upon affirmation by the Borrower or automatic acceptance by OCC at the end of the day, OCC will reduce the contract for the buy-in

7

The difference between the contract value and the buy-in settlement value will be settled the following morning by 10 a.m. EST

Lender Borrower

Transition to New Market Loan Program

As mentioned, the Hedge Program will continue to be supported along with the enhanced Market Loan Program for approximately one year after the Renaissance Initiative is launched. All Clearing Members must transition to the enhanced Market Loan Program. Hedge Clearing Members will automatically be approved for the Market Loan Program and will be encouraged to initiate stock loan transactions directly with OCC instead of submitting transactions to the depository for Hedge processing.

To prepare for the transition to the enhanced Market Loan Program, Hedge Clearing Members will need to complete various requirements leading up to the launch of the new platform. In the future, specific dates for completing each of the below requirements will be made available:

- Cease sending delivery orders to the depository and begin sending transactions to OCC
- Third-party service providers may assist with this by submitting transactions on behalf of participants
- Authorize OCC to submit the depository deliveries and receives on their behalf
- Make any operational and/or systemic changes necessary to handle affirmation(s)
- Submit re-rate and recall transactions to OCC
- End current processes for monthly rebate settlement with each counterparty, as this process will be replaced by OCC settlement.
- End current claims process for cash distributions, as this will also be replaced by OCC settlement.

Required Testing

As mentioned, to support the stock loan changes, OCC will require testing with Clearing Members and third-party service providers. Rest assured, OCC will continue to work with members and third-party service providers throughout this transition.

- **DDS Changes** – OCC will be modifying DDS for both Hedge and Market Loan. All stock loan Clearing Members and third-party service providers are expected to test with OCC. Detailed testing information will be available later this year.
- **Direct Submission by Participants** – Clearing Member and third-party service providers who intend to directly submit their transactions must test with OCC and be certified on their submissions before production go-live.

Changes to OCC's Stock Loan Programs are subject to regulatory approval. A more detailed discussion, including any changes to the enhancements discussed herein, will be available in forthcoming regulatory filings.

About OCC

The Options Clearing Corporation (OCC) is the world's largest equity derivatives clearing organization. Founded in 1973, OCC is dedicated to promoting stability and market integrity by delivering clearing and settlement services for options, futures and securities lending transactions. As a Systemically Important Financial Market Utility (SIFMU), OCC operates under the jurisdiction of the U.S. Securities and Exchange Commission (SEC), the U.S. Commodity Futures Trading Commission (CFTC), and the Board of Governors of the Federal Reserve System. OCC has more than 100 Clearing Members and provides central counterparty (CCP) clearing and settlement services to 19 exchanges and trading platforms. More information about OCC is available at www.theocc.com.

About the Renaissance Initiative

The Renaissance Initiative is a multi-year technology modernization project that will evolve our architecture from monolithic to modular. When completed, Renaissance will deliver increased business agility, more efficient and effective operations, and scalable technology that is more resilient for our participating exchanges, Clearing Member firms and market participants. Market users will experience benefits including more intuitive interfaces, self-service reporting, strengthened analytics with enhanced data access, customized solutions, and our ongoing commitment to data and cyber protection.

Questions?

Please contact:
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