



THE OPTIONS CLEARING CORPORATION

#21363

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DATE: JANUARY 20, 2006

SUBJECT: POST TRADE ALLOCATIONS

I. Overview

In response to OCC's growing presence in the futures marketplace and our commitment to providing superior services to both the options and futures markets, OCC will be introducing a futures-style post trade give-up process. The new Allocation post trade functionality will be available through ENCORE on Monday January 30, 2006.

The OCC post trade Allocations process will provide Clearing Members with a way to move executed trade quantities from the Executing Clearing Member to the ultimate clearing entity for all OCC cleared products. Post execution instructions will be communicated to OCC through ENCORE or via FIXML messages. Options and futures Allocations will affect a position transfer through separate allocation transactions which are **not** specifically tied to original trades. The net outcome will be a transfer of positions, at the original trade price or an average price between parties.

Note: Allocations for positions in security options and security futures will not be available until the SEC has approved the use of allocations for such positions. The Allocation system will immediately be available for commodity contracts (i.e., futures and futures options) that are subject to the exclusive jurisdiction of the CFTC.

II. New & Updated ENCORE Functionality

A. Screens

1. Allocation Agreements

Allocations indicate that the Executing and Give-Up firms have negotiated a give-up agreement. Members do not need to file the agreement with the Clearinghouse, but if they do some claims will be automated. A CMTA agreement does not qualify as a valid allocation agreement, therefore options Clearing Members will be required to maintain both sets of agreements separately.

If a Clearing Member wishes to automatically accept incoming allocations, they should input an allocation agreement. These agreements could be either general by stating that the Clearing Members are willing to accept allocations at a firm to firm

level, or specific by stipulating certain customer account #s which the Give-Up Clearing Member is willing to have automatically processed.

a) Add Allocation Agreement

This is accessed from the current CMTA Maintenance screen. Allocation will be a new CMTA Type in the drop-down box.

b) Accept Allocation Agreement

Allocation agreements will only be effective upon acceptance by both sides of the agreement. The accept (all) button can be used by the counterparty to accept incomplete agreements. The action required column will show “Executor/Give-Up: Approve Add” when acceptance is needed.

c) Delete Allocation Agreement

Valid allocation agreements can be deleted. One side of the agreement will need to select the agreement from the CMTA Maintenance listview screen and click delete (all). OCC will continue processing allocations against this agreement until the end of the current business date. In order for the delete to be immediately effective the other side of the agreement must also click delete on the listview screen.

2. Position Movement

The Position Movements screen in ENCORE is used by Clearing Members to effect post trade transactions at the OCC. Allocations will be a new transaction type available on this screen.

a) Allocation Listview

From the Position Movement Filter, members may filter on the new allocation transaction type in order to see all of their allocations for the chosen activity date. The results could also be filtered by transaction status (claimed, unclaimed, rejected), as well as all of the standard post trade filter criteria (account, instrument, etc.).

b) Add Allocation

If a clearing member wishes to transfer a position via an allocation they can initiate this through the Add allocation screen. This can be accessed from the position movement listview screen by clicking the Add button. On the Add screen the Allocation transaction type should be selected and all of the relevant details to the transaction should be completed.

c) Modify Allocation

Once an allocation has been added and has passed the required system validations it will be shown on the position movement listview. From this screen the originator of the transaction may select the record and click the modify button. If the allocation is unclaimed, any of the fields may be changed by the originator. If the allocation is claimed or rejected, only the remarks fields may be updated.

d) Delete Allocation

From the position movement listview screen, the originator of an allocation may select a record and delete it. This will only be allowed for unclaimed allocations.

e) Accept (All) Allocation

Within ENCORE, the claiming process will begin from the listview screen for allocations. Only unclaimed allocations for the current business date may be claimed. Users can select single or multiple allocation records for acceptance. Once the “Accept” button is clicked, the allocation screen will be brought up so that the Give-Up firm can review the details of the transaction before confirming their acceptance of the position.

If the allocation listview contains multiple unclaimed allocations the contra side may choose to click the Accept All button. This will immediately update the status of all of the records.

f) Reject (All) Allocation

If the Give-Up firm is not willing to accept the Allocation for any reason, they should select the unacceptable records and click the “Reject” button. When this happens the Give-Up firm will have an opportunity to state their reasons for rejection in the remarks field.

g) Generate Allocation from Trade Inquiry

From the Trade Inquiry screen, users will be able to select trade records for Allocation. After selecting the trades that they wish to allocate, originators may choose “Position Movement” from the “Go To:” drop-down box. The Add Position Movement screen would open and will be automatically populated (but editable) with the information from the Trade Inquiry screen. Users would then choose Allocation from the Transaction Type drop-down box and complete the Allocation.

If multiple records on the Trade Inquiry were selected then the allocation quantity would be the sum of the trade quantities (assuming they are the same series/contract). Also the allocation price will be an average of the individual trade prices.

h) Generate Allocation from Position Inquiry

Clearing Members may also select positions that they wish to allocate out from the positions inquiry listview screen. The users can select a position record and choose “position movement” from the “Go To:” drop-down box. The Allocation screen would be automatically populated (but editable) with the information from the Position Inquiry screen.

B. Reports

1. Allocations Report (On-Demand and Core)

There will be a new On-Demand and Core report available to members for their allocation activity. This daily report will display all of the claimed, unclaimed and rejected Allocation activity.

2. Daily Positions Activity Report (On-Demand and Core, Options and Futures)

The existing On-Demand and Core version of the Daily Positions Activity Report (both Options and Futures versions) has been updated to include allocations activity. The reports will now include lines for incoming and outgoing allocations. If the transactions involved an average price with a residual amount, this will be included in the settlement amount reported and will be indicated by “(w/ res.)”

3. Trade Inquiry Report (On-Demand)

The Trade Inquiry screen and report have been updated to better support post trade allocations. If the account # at the executing clearing member was marked on the trade, it is now displayed on the screen and report. The report has also been updated to include the allocation type indicator from the trade. Members may wish to use these data elements in determining their post trade allocations.

4. CMTA Agreements Report (On-Demand)

The CMTA Agreements report has been updated to display allocation agreements.

C. DDS & FIXML Messaging

OCC will produce data service messages for Allocations using the new Data Distribution System (DDS). The Allocation Report message will be a new message type available to DDS subscribers. Please note that the fixed-length, legacy data service system will not support Allocations.

1. Allocation Report

Once the executing clearing member has input a valid allocation, a FIXML notification will be sent to the give-up firm alerting them that there is an allocation pending which requires their attention. Carry firms will then be able to accept or reject allocations through ENCORE. Once claimed and rejected allocations are processed, the executing and give-up clearing members will be notified through an Allocation Report message. These notifications will be done according to the recipient's DDS profile. Allocation Report messages will be available in real-time or batch according to member's DDS subscriber profile.

OCC's DDS Reference webpage

http://www.theocc.com/products/dds_ref_materials.jsp will be updated to include the allocation messages. Members may also contact their Member Services representative for a complete Allocation Report message layout.

D. Phased Implementation

OCC will be implementing the Allocations system in two phases.

The first phase, to be installed on January 30, 2006, will provide all of the necessary screens, reports, and data service needed in order to perform Allocations. This includes all of the functionality discussed above.

The second phase of this project, planned for early second quarter 2006, will provide additional functionalities to support automated solutions, internal sub-allocating, and other general enhancements.

E. Phase Two Functionality

1. Automated Generation of Allocations

Currently the process of allocating trades is carried out at the exchanges. Firms will have the opportunity to continue to allocate trades through exchange systems or they may choose to interact with OCC. If members wish to use exchange systems to automate the creation of OCC allocation records then they may mark the trade for give-up and supply a give-up clearing member. When OCC receives a trade which indicates that it is to be given-up (Allocation Type = "G"), and it has a Give-Up Clearing Member number, OCC will bucket the trade in the executor's position account and automatically generate the allocation. Once the allocation has been created it will follow the same process as if it were a manually entered transaction. If claimed, the allocation will offset the original trade in the executor's account.

2. Sub-Allocations

As discussed above, Clearing Members will be able to Accept Allocations from the Position Movement listview screen. With phase two, users will be able to break up the allocation among multiple clearing or internal positions accounts.

3. DDS & FIXML Messaging

a) Allocation Instruction

In the second phase, the originating Clearing Member will also be able to initiate an Allocation through a FIXML Allocation Instruction message. Once OCC has validated and processed the Allocation Instruction message, an Allocation transaction will be created in ENCORE.

b) Allocation Report

If a valid Allocation Agreement between the originating and contra clearing members has been entered in ENCORE the transaction will automatically be claimed and a completed Allocation Report message will be sent to both parties of the transaction as well as any regulators and exchanges.

If an Allocation Agreement is not found, the Allocation will have an Unclaimed status and a notification will be sent to the Contra Clearing

Member. This notification will also be done using an Allocation Report message. The RptType = 11 (Accept Pending) will signify this.

c) Allocation Report Ack

The Contra Clearing Member may also send OCC a FIXML message indicating whether they would like to claim or reject the pending allocation. The message for this will be the Allocation Report Ack. This message must specifically reference the unclaimed Allocation Report message OCC produced by citing the AllocID of the original message.

Once OCC processes the claim or reject message a completed Allocation Report message (see above) will be sent to the originating and contra sides stating whether the allocation was claimed or rejected.

4. Generate Grouped Allocations from Trade Inquiry

As discussed above in the phase one functionality section, users will be able to select trade records for Allocation from the Trade Inquiry screen. Phase two will allow users to select multiple trades and allocate them as a single position movement. If multiple records on the Trade Inquiry were selected, the allocation quantity would be the sum of the trade quantities (assuming they are the same series/contract). Also the allocation price will be an average of the individual trade prices.

5. Billing Enhancements

OCC will provide Clearing Members with information about the clearing and regulatory fees associated with Allocation transactions. CMTA Transfer records (Trade Capture Report) will also be enhanced as part of this project so that they show billing amounts in the same manner as Allocations. On the Allocation Report and Trade Capture Report messages, (when the records have been processed by the clearinghouse), we will report the amount which will be charged for clearing and regulatory fees. The clearing fees are calculated using current fee schedule. In all cases the clearing fee will be reported as a debit (charge), to the recipient of the position and a credit (collect), to the clearing member giving up the position.

Note: This is only a reporting change and the end of month billing will not be adjusted.

In addition to reporting billing information on the Allocation Report and Trade Capture messages, OCC will produce an end of month report which will detail all of the past month's Allocations and CMTA Transfers and the billing amounts associated with those transactions.

Clearing Members wishing more information or training are encouraged to contact their Member Services representative or the OCC Help Desk at (800) 621-6072.