



ISO 27001 Certified

National Clearing Company of Pakistan Limited

8th Floor, Pakistan Stock Exchange Building, Stock Exchange Road, Karachi

NCCPL/SLB/AUGUST-16/02

August 23, 2016

Concept Paper - Improvements in the SLB System

Dear Clearing Members,

An automated Securities Lending and Borrowing (“SLB”) platform was introduced by the National Clearing Company of Pakistan Limited (“NCCPL”) in 2011. The main objective was to facilitate the Market Participants in managing delivery failure and to carry out short sales transactions in the market within the applicable regulatory framework.

Capital market has shown tremendous growth over the past few years, however, activity remained at negligible level in the SLB Market. In the absence of vibrant market for securities lending and borrowing, short selling may not work effectively. In view of above, NCCPL and PSX, in consultation with the Securities and Exchange Commission of Pakistan (SECP) have reviewed the entire process and make proposals for the improvement in the SLB System.

We are enclosing herewith a draft concept paper pertaining to such proposals for the consultation of market participants. Clearing Members are requested to review the same and provide us your feedback/comments on the same in writing till September 01, 2016.

For any further queries or concerns, please feel free to contact the Customer Support Services of your respective locations.

City	Telephone Number	UAN Number	Fax Number
Karachi	021-32460811-19 Ext. 214, 217 & 218 Dir. 021-32438531-32-33	021-111-111-622	021-32462825
Lahore	042-36280815-7		042-36280818
Islamabad	051-2895460-62		051-2895463

Regards,

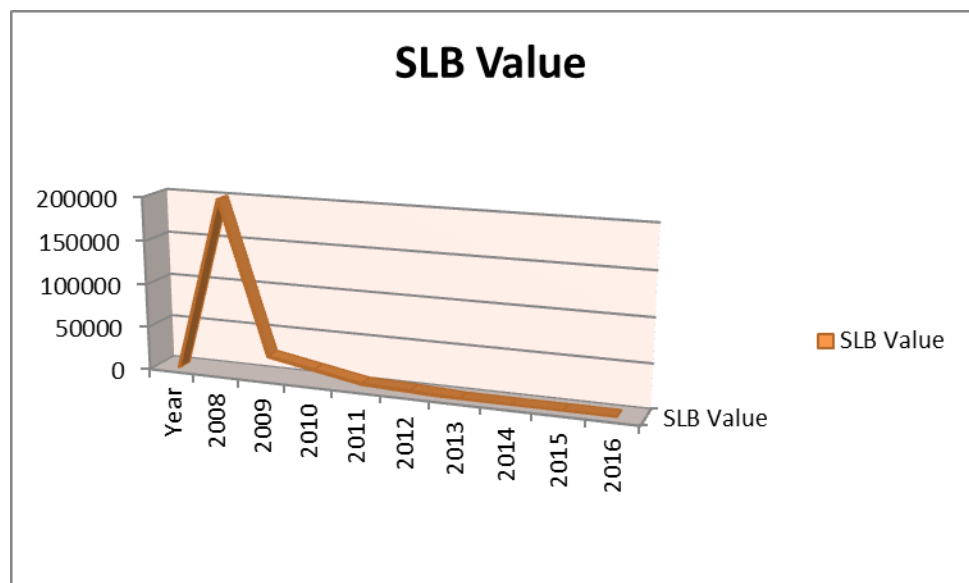
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Rehan Saif
Head of PD & CSS

CC:

1. Executive Director - Policy, Regulation and Development Department - SMD
Securities & Exchange Commission of Pakistan - Islamabad
2. Managing Director - Pakistan Stock Exchange Limited

cNs—Stock Lending and Borrowing



4/4/2016

Pakistan Stock Exchange

cNs—SLB
THE WAY
FORWARD→

Considering that existing Lending and Borrowing System has failed to takeoff, the office of the Exchange has developed an enhanced version of the Stock Lending and Borrowing. This discussion paper shall undergo the standard input, assessment and feedback process before accreditation and/or implementation.

The Share Financing and Stock Borrowing are the two impetuses which provide speculators to take view on bullish and bearish trends.



Our market is somehow perceived to be heavy on bullish side speculative products.

PAKISTAN STOCK EXCHANGE LIMITED
(Market Development and New Product Committee)

Apr 04, 2016

WORKING PAPER

STOCK LENDING AND BORROWING SYSTEM, (SLB) ADVANCED

Stock Lending and Borrowing Contracts were introduced in 2011 by National Clearing Company of Pakistan. The Product has failed to meet the expectations of Borrowers and Lenders of the Market and has also failed to provide required impetus to the Market thereby bringing required vibrancy to the Market. The aggregate borrowed number of shares since launch of SLB stood within a million in past five years along with 68 registered participants of Stock Lending and Borrowing Market.

Bullish, Supportive Products and Regulations: A system that allows the facility of carry forward transaction from one settlement period to another is known as “Badla System”. The greatest advantage of “Badla System” was that it allowed the expansion in the market size besides providing excellent liquidity. The Badla Systems encouraged mindless speculation leading to high volatility in stock prices, it was discontinued in 2005, and CFS was introduced, later on in 2008, the latest version of CFS MKII was banned and MTS was introduced. It is perceived to be a common phenomenon that an ordinary man on the street comes to grief periodically, while a handful of big players decamp with contrived windfall.

Bearish, Supportive Products and Regulations: In the absence of vibrant market for securities lending and borrowing, short selling may not work effectively. Many international jurisdictions permit short sales in any security. In the Indian context, at present there is no distinction between naked and covered short sales in any regulation or any statute governing the securities market. Naked short sales would show up as settlement shortages. As a result, there are no unsettled outstanding positions and naked short sales, even if it takes place, have not posed any threat to market stability.

In view of above, it may be considered that the retail investors should be allowed to square-off their positions intra-day and the institutional investors should be prohibited from day-trading.

1. Introduction to cNs-SLB

In order to facilitate an efficient and transparent lending and borrowing for equities in the market, this paper proposed the lending of securities by eligible participants such as banks and NBFIs, high net worth individuals etc through eligible intermediaries as per NCCPL Regulations. This arrangement would benefit investors, Borrowers as well as Lenders who are intending to lend and/borrow securities; hence, cNs-SLB will create a bulk pool of securities thereby providing liquidity to market at the retail level. This pool of securities shall ensure availability of lent securities for 14 days.

Authorized Lenders will input, on real time basis, offers for shares that they want to lend at desired rates, whereas Borrowers may either accept the offer on the screen or put in their own bid for specified scrip at a specified rate, which the AL can in turn accept thus concluding the contract.

Collateral will be based on VaR methodology and margins will be held in form of approved securities, mark to market losses, along with existing **Special Margins being capped at 5%**, will be collected on a daily basis in order to manage the settlement risk. The said Special Margins are recommended to be removed after a period of 1 year post launch of cNs SLB product.

2. Salient Features of cNs-SLB

All the TREC Holding Members of PSX will have access to securities for and on behalf of their clients and for their own account and shall be eligible to lend and borrow securities on their own account or on behalf of their clients.

2.1 Lenders cNs-SLB

All eligible lenders, intending to lend, can lend at given rates for specified scrip, withdraw such offers, and/ or change the rate till such time that the offer is accepted. Once accepted, the offer becomes irrevocable and the contract becomes firm.

Sr. #	Direct Lenders	Lending through Brokers
1.	TREC Holders	All Individuals, Private Companies and other Institutional Clients
2.	Non Broker Clearing Members (NBCM) of NCCPL	

	All Existing Categories. However, Insurance Companies will be added as SLB Lender	
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2.3 Borrowers, cNs-SLB

All the TREC Holding Members will have access to securities for and on behalf of their clients and for their own account.

2.4 Modus Operandi for cNs-SLB

- The proposed cNs-SLB Market should observe the same Market Operation timings as that of Ready Market.
- Authorized Lenders shall input number of specified shares required to be lent together with required rate of lending on their own account and on behalf of their Clients. A special window shall be incorporated in the SLB bid/offer screen which shall generate an alert when a lending/borrowing rate beyond KIBOR+8 is entered with a view to seek an assurance that entered lending/borrowing rates had no type error.
- The rate for lending and borrowing should be determined by the market forces on the basis of demand and supply without any capping. All offers and bids will be transparently displayed on system.
- Borrowers will have access to all unmatched offers available on each share, upon matching of bids and offers, SLB contract will be confirmed and shall be deemed irrevocable.
- Borrower will be able to place his own rate for borrowing shares which lender may accept for lending the securities in a transparent and open manner. Given below are the keys aspects of the proposed cNs-SLB Contract:

- The concept of Term Book Trading is proposed to be applied in the following manner:

Separate Contracts ranging from single working day to 14 working days are to be made available at all the times, except for the situations, where book-closures are impending within fourteen days.

Each and Every Contract shall have a fixed maturity date.

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- The determination of lending and/or borrowing rates shall be at the disposal of the market forces.
- All cNs-SLB Contracts shall be European style contract, in case of an earlier release of cNs-SLB contract by the borrower, the borrower shall be required to pay full rental as per the term of the cNs-SLB contract.
- Each and every Contract shall be released before the start of ready market on the date of its maturity.
- Phasing out Special Margins: Special Margins were introduced some ten years ago and as such these margins have either been concluded or replaced with concentration margins. Previously, at the time of re-launch of leveraged products, special margin which was implemented at that time had replaced with the concentration margin. However, this was only implemented in MTS and special margin remained allocable due to lack of liquidity. This paper suggests removing the special margins and introducing Concentration Margins in line with the slabs for MTS, which shall be payable by both the borrower and lender at end of each day at in the following manner:

MARKET-WIDE SECURITY CONCENTRATION SLABS AND RATES					
Greater than	2	"	Greater than	2.9	1.61
	6	"	Greater than	4.3	3.23
	8	"	Greater than	5.7	4.84
	10	"	Greater than	8.6	6.45
	12	"	Greater than	14.3	8.06
	14	"	Greater than	20	9.68
MEMBER-WIDE SECURITY CONCENTRATION SLABS AND RATES					
Greater than	5	"	Greater than	0.6	1.61
	10	"	Greater than	0.9	3.23
	20	"	Greater than	1.1	4.84
	30	"	Greater than	1.4	6.45
	40	"	Greater than	1.7	8.06
	60	"	Greater than	2.0	9.68
UIN-WIDE SECURITY CONCENTRATION SLABS AND RATES					
Greater than	1	"	Greater than	0.17	0.81
	2	"	Greater than	0.25	1.61
	4	"	Greater than	0.33	2.42
	8	"	Greater than	0.42	4.03
	16	"	Greater than	0.50	5.65

- Neither Lender nor Borrower will know who the counter party is, as they (borrower and lender) are essentially dealing through an undisclosed system.

On settlement of first ticket, lender will deliver Securities to Borrower and will get proceeds of lend securities on T+2.

On the other hand, if borrower executes short sell in the market, on the settlement date, due to netting of SLB and Regular Market in NCSS, obligation of Borrower (Ready Sell and SLB Borrow (buy)) will be netted on T+2. Accordingly, ready market buyer will make payment to NCCPL on T+2.

- On the settlement of second ticket, the payments against the shares purchased by the borrower are made by the lender.

2.5 Cost of Borrowing

Cost of borrowing will be determined by market, based on demand and supply.

2.6 Shares Eligible for cNs-SLB

- Eligibility Criteria for SLB Short Selling Securities will be reviewed in later stage considering liquidity and demand of market participant for other securities.

2.7 Margins Required from Lender

Lender will pay margins/MTM Losses on all open lending positions till settlement of SLB R Transactions

- Collection of Mark-to-Market Losses shall be in form of cash only

2.8 Margins Required from Borrower

- Borrowers will also pay margins /MTM Losses on all open lending positions till settlement of SLB R Transactions Deposit against exposure will be accepted in the shape of eligible shares, cash or any other acceptable security duly approved by competent authorities such as T Bills, or bank guarantee (in agreed format) to cover Borrower's open positions.
- Collection of Mark-to-Market Losses shall be in form of cash only.

2.9 Valuation of Collaterals and Standard Haircut

Existing haircuts shall apply on the Margin Eligible Securities:

(a) Bank Guarantees/T-Bills

Bank Guarantees/T-Bills will remain applicable as a mode of collateral as per existing risk management regime.

2.11 Default Procedure

Default means that a Borrower or Lender does not deposit a margin call within the stipulated time; or does not make the required payment or deliver shares to settling entity by the stipulated time on settlement. In such event the existing default management Regulations of NCCPL will prevail.

2.12 Position Limits:

Positions Limits applicable for SLB Market presently will remain as it is at this stage. This may be reviewed subsequently considering liquidity in SLB. In addition to this, Member-wide and client-wide limits may also be implemented on SLB Lenders. Position limits shall also be applicable on the lenders.

2.13 Corporate Action

The treatment of corporate action shall continue to function as it is until the first review of revised SLB. As mentioned above, contracts will not be opened where the book closure is falling before the settlement date.

3. Time Frame for Implementation

The expected date for the implementation of the above mentioned process is October 25, 2016.

4.

5. Enclosures

- NCCPL's existing schedule of Charges
- Comparative Analysis of Indian and Pakistani Model of SLB along with proposed Model

ANNEXURE A
EXISTING SCHEDULE OF CHARGES IMPOSED ON VARIOUS ACTIVITIES IN
STOCK LENDING AND BORROWING MARKET

S. No.	Name	Rate	Basis	Levied On	Collection	
					Time	Mode
1	SECP Levy	Rs. 0.19	Per Rs. 100,000 value of MF, MT and SLB multiplied by No. of days of respective Contract	Authorized Financier and Financee	Month end	Through NCSS Pay & Collect
2	Transaction fee for SLB	Rs. 1.50	Per Rs. 100,000 value of SLB Transaction multiplied by No. days of SLB Contract	SLB Participants	Month end	Through NCSS Pay & Collect
3	Contribution for NCC Clearing and Settlement Fund in respect of SLB Transactions	Rs. 1.50	Per Rs. 100,000 value of SLB Transaction multiplied by No. days of SLB Contract	SLB Participants	Month end	Through NCSS Pay & Collect
4	SLB Annual Fee	Rs. 250,000	Annual Fee for MT	Non Broker Trading Financier	Annually	Through NCSS Pay & Collect

**ANNEXURE B
INDIA /PAKISTAN COMPARATIVE**

Sr. No.	Practice followed in India for SLB Market	Practice followed in Pakistan for SLB Market	Proposed Practice
1.	<p><u>Tenure for SLB transactions</u> 12 fixed monthly tenures with fixed reverse leg settlement dates are available for transactions in SLB.</p>	<p><u>Tenure for SLB transactions</u> The tenure for SLB transactions is up to 1 month i.e. 30 calendar and 22 business days.</p>	<p><u>Tenure for SLB transactions</u> The tenure for SLB transactions is proposed to 14 calendar days, as the book-closure announcement requires a 14 days' notice.</p>
2.	<p><u>Lending fee</u> Lending fee is quoted on per share basis. Lending fee may be quoted based on the annualized yield expected by the lender or the cost which the borrower expects to pay.</p>	<p><u>Lending fee</u> Lending fee is quoted on KIBOR + 8% of total value</p>	<p><u>Lending fee</u> Lending fee is proposed to be quoted on per share basis without any ceiling or floor limit.</p>
3.	<p><u>Settlement cycle for a SLB Transaction</u></p> <p>T Day: The Transaction is executed on T Day between the lender and borrower.</p> <p>T+1 day: The Lenders are required to deliver the securities for pay-in on T+1 day. Securities are thereafter transferred to the borrowing participants during pay-out on T+1 day. The borrower shall bring the lending fee on T+1 which shall be passed on to the lender in the funds pay-out.</p> <p>Reverse leg settlement date: The borrower needs to deliver the securities at the time of pay-in which shall be returned back to the lender during the pay-out.</p>	<p><u>Settlement cycle for a SLB Transaction</u></p> <p>T Day: The Transaction is executed on T Day between the lender and borrower.</p> <p>T+1 day: The Lenders are required to deliver the securities for pay-in on T+1 day. Securities are thereafter transferred to the borrowing participants during pay-out on T+1 day. The borrower shall bring the lending fee on T+1 which shall be passed on to the lender in the funds pay-out.</p> <p>Reverse leg settlement date: The borrower needs to deliver the securities at the time of pay-in which shall be returned back to the lender during the pay-out.</p>	<p><u>Settlement cycle for a SLB Transaction</u></p> <p>T Day: The Transaction is executed on T Day between the lender and borrower.</p> <p>T+1 day: The Lenders are required to deliver the securities for pay-in on T+1 day. Securities are thereafter transferred to the borrowing participants during pay-out on T+1 day. The borrower shall bring the lending fee on T+1 which shall be passed on to the lender in the funds pay-out.</p> <p>Reverse leg settlement date: The borrower needs to deliver the securities at the time of pay-in which shall be returned back to the lender during the pay-out.</p>

4.	<p><u>Margins applicable to the borrower & lender on T Day</u></p> <p>a) In case of borrower only the lending fee is levied upfront as margin.</p> <p>b) In case of lender, 25% of the lending price (T-1 cash market closing price) and Mark to market (MTM) at end of day are charged to the lender. These margins are not applicable to lender in case if lender does Early Pay-in of securities.</p>	<p><u>Margins applicable to the borrower & lender on T Day</u></p> <p>a) In case of Borrower, VaR based Exposure Margins, MtM losses and Special Margins are levied as Margins,</p> <p>b) In case of Lender, VaR based Exposure Margins and MtM losses are levied.</p>	<p><u>Margins applicable to the borrower & lender on T Day</u></p> <p>- In case of borrower only the lending fee is levied upfront as margin.</p> <p>- In case of lender, VaR Margins Mark to market (MTM) at end of day are charged to the lender. These margins are not applicable to lender in case if lender does Early Pay-in of securities.</p>
5.	<p><u>Margins applicable to the borrower & lender from T+1 to Reverse leg settlement day (Reverse Leg)</u></p> <p>a) No margins are levied on the lender</p> <p>b) 100% of lending price, Value at Risk margins, Extreme Loss Margins (same as applicable in Cash market for buying or selling a security) and EOD MTM are levied on the borrower.</p>	<p><u>Margins applicable to the borrower & lender after the settlement on T+2 day</u></p> <p>Lender will pay the MtM losses till the release of the SLB transaction</p>	<p><u>Margins applicable to the borrower & lender from T+1 to Reverse leg settlement day (Reverse Leg)</u></p> <p>a) On T+1, no margins are levied on the lender</p> <p>b) 100% of lending price, Value at Risk margins, Extreme Loss Margins (same as applicable in Cash market for buying or selling a security) and EOD MTM are levied on the borrower.</p> <p>c) Lender starts paying VaR Margins and MTM losses from T+2 until settlement of reverse leg.</p>
6.	<p><u>Collaterals needed towards margin requirement</u></p> <p>The margins are collected from the collaterals of participant/custodian. Participant/Custodian can provide collaterals in form of cash, fixed deposit or bank guarantee.</p>	<p><u>Collaterals needed towards margin requirement</u></p> <ul style="list-style-type: none"> • VaR based Exposure Margins are in the form of Margin Eligible Securities, Cash, Bank Guarantee, Irrevocable Under-Taking and T-Bills • MtM losses are in form of cash only • Special Margins are collected in the form of cash, Bank Guarantee, Irrevocable Under-Taking and T-Bills. 	<p><u>Collaterals needed towards margin requirement</u></p> <p>The margins are collected from the collaterals of participant/custodian. Participant/Custodian can provide collaterals in form of cash, fixed deposit or bank guarantee.</p>
7.	<p><u>Early repayment of securities by the borrower</u></p>	<p><u>Early repayment of securities by the borrower</u></p> <p>The Borrower may release SLB transaction at</p>	<p><u>Early repayment of securities by the borrower</u></p> <p>A participant having an existing borrow position</p>

	<p>A participant having an existing borrow position can repay the securities to NSCCL. On receipt of securities the margins levied on borrower are immediately released. The borrower can further lend the securities for the balance period of the tenure. For this the borrower needs to enter a repay order on the trading terminal by selecting order type as “Repay”. The borrower shall quote the fee he expects to receive for the balance period. In case the order is matched successfully then the settlement of the early repay transaction shall happen on a T+1 basis. After successful completion of pay-in the position of the borrower shall cease to exist. Repay orders can be entered up to 3 days prior to the respective reverse leg settlement day. The orders can also be entered for partial quantity.</p>	<p>any given point of time during 22 working days. At the time of the release of SLB transaction the Lender is required to pay 100% of amount of the lent securities (after the adjustment of premium if any) and receive the lent securities.</p>	<p>can release and repay the securities to Authorized Intermediary. On receipt of securities the margins levied on borrower are proposed to be immediately released.</p> <p>The borrower can further lend the securities for the balance period of the tenure by entering a fresh offer in e—SLB system.</p>
8.	<p><u>Action taken if the lender fails to deliver securities on T+1 day</u></p> <p>The transaction shall be financially closed out at the below rate</p> <ul style="list-style-type: none"> • 25% of closing price of the security on T+1 day (closing price for the security in the capital market segment of NSE), or • (Maximum trade price of the security in the capital market segment of NSE from T to T+1 day) - (T+1 day closing price of the security in capital market segment of NSE) 	<p><u>Action taken if the lender fails to deliver securities on T+2 day</u></p> <ul style="list-style-type: none"> • NCCPL shall initiate the square up of the failed deliveries and give the required number of shares to the Borrower, • In case, if NCCPL is unable to purchase the number of shares from the square up market, such transaction will be closed out. 	

9.	<p><u>Action taken if the borrower fails to bring securities at the time of reverse leg settlement</u></p> <p>If the borrower fails to deliver the securities NSCCL conducts a buy-in auction to acquire the securities on the reverse leg settlement date. If securities are not available in auction then the transaction is financially closed out at the below mentioned close out rate.</p> <ul style="list-style-type: none"> • Maximum trade price in the capital market segment of NSEIL from (reverse leg settlement day – 1 day) to reverse leg settlement day, or • 25% above the closing price of the security in the capital market segment on the reverse leg settlement day. 	<p><u>Action taken if the borrower fails to bring securities at the time of settlement on T+2</u></p> <ul style="list-style-type: none"> • NCCPL shall initiate the square up of the failed deliveries and give the required number of shares to the Borrower, • In case, if NCCPL is unable to purchase the number of shares from the square up market, such transaction will be closed out. 	<p><u>Action taken if the borrower fails to bring securities at the time of settlement on T+2</u></p> <ul style="list-style-type: none"> - Initiate the square up of the failed deliveries and give the required number of shares to the Borrower, - In case, if securities are unavailable in the square up market, such transaction may be closed on 25% above the high or close price of that day.
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