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Securities Lending and Borrowing (SLB)

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- What is SLB?
- Legal and Regulatory Framework.
- Who will participate in SLB.
- Benefits of SLB
- SLB Process Flow
- Risk Management

WHAT IS SLB

- Securities Lending and Borrowing (SLB) is the temporary transfer of securities from one party- the lender, to another - the borrower, at a fee (lending fee), with a simultaneous agreement to return the securities either on demand or at a future date.
- SLB will be undertaken on securities that are listed on the Nairobi Securities Exchange.
- There are two models through which SLB can be carried out;
  - Bilateral Model
  - Screen based Model

LEGAL AND REGULATORY FRAMEWORK

- The overarching legal and regulatory framework for SLB is the Capital Markets Act and the Capital Markets (Securities Lending, Borrowing and Short selling) Regulations 2017.
- The SLB Regulations currently provide for the bilateral model of SLB.
- The Screen-based SLB Model will be operationalized under the Central Depositories Act, the Central Depositories (Securities Lending and Borrowing) Rules and the Central Depositories (Securities Lending and Borrowing) Procedures.
- CDSC has been admitted to the CMA Regulatory Sandbox where the Screen-based model will be tested under the Pilot Phase.

WHO WILL PARTICIPATE IN SLB?

- Securities Lending and Borrowing Agents appointed by CDSC will transact on behalf of their clients.
- Some of the clients include:
  - Fund managers
  - Collective Investment Schemes
  - Investors
  - Brokers/ Dealers

BENEFITS TO THE LENDER

- The lender will receive income from the securities they lend out, without having to liquidate their portfolio.
- The lender does not have to look for borrowers in order to lend securities.
- The lender does not have to manage the collateral since CDSC will perform this function.
- The securities are transferred automatically without requiring the signing of physical documents.
- The lender will receive all corporate actions that take place during an SLB transaction.
- No counterparty risk as transactions are guaranteed by CDSC.

BENEFITS TO THE BORROWER

- Additional income to the borrower.
- Supports trading and investment strategies e.g. short selling.
- Screen based model ensures that borrowers can view securities on offer to enable them to quickly take advantage of opportunities that arise.
- No counterparty risk as transactions are guaranteed by CDSC.
- Immediate automated transfer of securities ensures that borrowers receive securities in a timely manner.

BENEFITS TO THE MARKET

- Increased liquidity
- Enables participants to cover temporary shortfalls or overall net debit positions in CDSC at settlement time.
- Market makers are enabled to borrow securities in order to make two-way quotes.
- Additional income for the market (Commissions and transaction levies).

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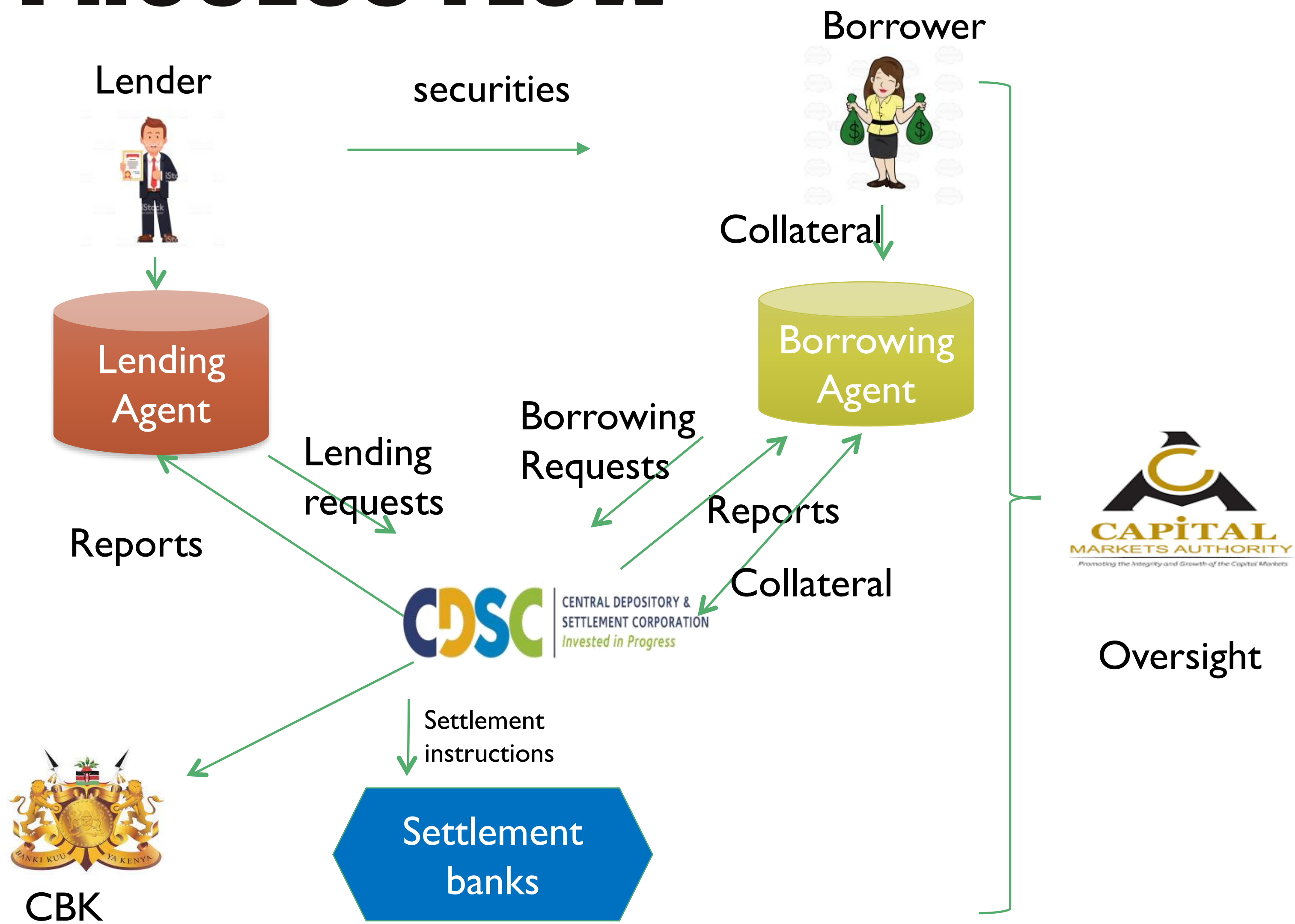
ELIGIBLE SECURITIES

- The NSE 20 share index securities as updated from time to time.
- The Securities to be lent must have been previously deposited in the CSD and must be balance free.

ACCEPTED COLLATERAL

Government Securities

PROCESS FLOW



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MATCHING THE REQUESTS

- Ability for all agents to view all lending and borrowing requests
- Automated matching of requests according to the following criteria;
  - Time
  - Security
  - Quantity
  - Lending fee
  - Duration
- After matching securities move from the lender's CSD account to the borrower's account and collateral is blocked.

EARLY RETURN OF SECURITIES

1. The lender has the option to recall securities earlier than the due date but will be required to give a 14 day notice.
2. The borrower will be able to return the securities earlier than the return date.
3. Since the lending fee accrues daily, the lender will only receive the fee that will have accrued up to the point the securities are returned

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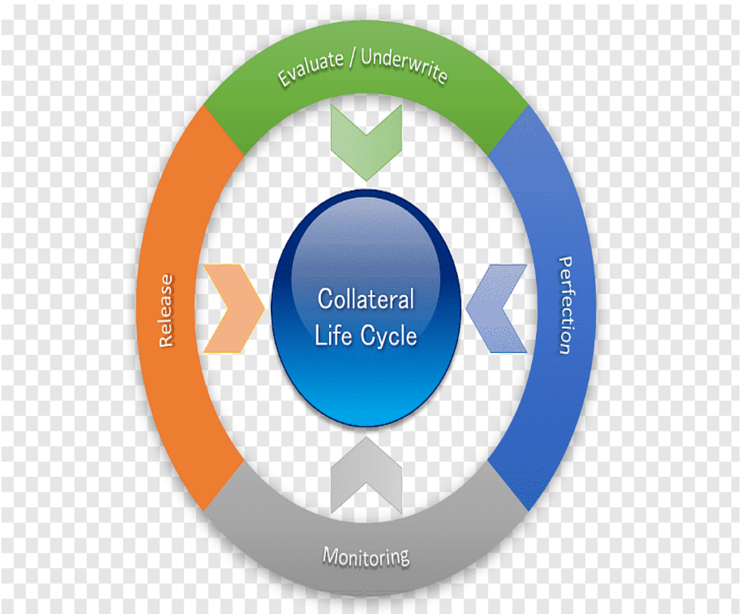
SETTLEMENT OF SLB TRANSACTIONS

- Advance notifications to SLB agents before due date
- Automatic return of securities at end of day on due date
- Settlement on the day after return date
- Settlement through settlement banks and CBK
- Guarantee fund to cover any funds shortfall
- Buy-in in case of failed delivery

COLLATERAL MANAGEMENT



- ✓ CDSC to manage collateral
- ✓ Cash collateral to be held in accounts to earn interest.
- ✓ Interest earned belongs to the borrower
- ✓ Securities collateral to be pledged in favor of CDSC
- ✓ CDSC will charge a management fee on cash collateral

SLB COLLATERAL AND MARGINS

- Collateral of 100% of the value securities borrowed.
- Initial margin of 10% to cover price movements.
- Daily marking to market of securities.
- Margin calls by CDSC.

REPORTS AND CLIENT STATEMENTS

- Automated Reports for the agents and the settlement banks availed in the system.
- Client's statement to display outstanding balances of borrowed or lent securities.

CORPORATE ACTIONS

Borrower to pay lender any dividends paid during the duration of the contract or provide additional securities in case of a bonus or split.

Risk Management

Risk	Mitigation
Credit Risk	Collateral to be maintained at 110% of the value of the securities borrowed
	Daily mark-to-market of the lent securities and collateral (non-cash) with daily margin calls.
	Borrower to provide collateral before placing a borrowing request and this collateral is reserved immediately an SLB transaction is executed/matched.
	Borrower may request for return of excess collateral
	Settlement Guarantee Fund in place
	Buy-in and Cash equivalent compensation for failed return of securities paid by the collateral provided
Liquidity Risk	The Authority has proposed to prescribe that only liquid securities (constituents NSE20 index) may be lent/borrowed
	The quality of the collateral required in a securities lending or borrowing transaction restricted to cash in Kenya shillings; and Government securities.
	SLB regulation restricts reuse of collateral
	A notice of up to 14 days by the lender to the borrower when recalling lent securities.

Risk Management

Risk	Mitigation
Collateral Investment Risk	SLB Regulations limit reinvestment of collateral to interest bearing deposits for cash and overnight repo for GoK securities.
	Collateral to be held with credit worthy tier I Banks
Operational Risk	Rules and Operational Procedures
	The new system ability to support the SLB framework have been tested and noted to be adequate
	Indemnification mechanisms by the agents and CDSC provided for in the SLB Rules and contracts.
Market Risk	Daily Mark-to-Market, Initial Margin requirement, restriction on collateral reinvestment
Legal Risk	Admission in CMA's Regulatory sandbox for piloting of screen-based SLB
	Standardized Master Agency Agreements

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THANK YOU

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