

## SECURITIES LENDING AND BORROWING (SLB)

### 1. Brief Background:

The passage of the PFRDA Act in September 2013 followed by notification of the Act on 1st February 2014 marks an important milestone in the history of the Pension Sector reforms as the Act provides an overarching mandate to the PFRDA for promotion and development of old age security in India. In light of the paradigm shift in the pension landscape in the country, it is imperative to review the progress of NPS so far and realign the existing policy framework for Pension Funds within the mandate of the Act.

Besides the expansion in coverage, the provision of old age income security also entails working towards adequacy of income post working life, which can be done by optimizing returns through appropriate investment guidelines. While devising the investment guidelines, the interest of the subscriber is to be kept paramount, balancing the security aspect with adequacy of returns. Keeping this in view, an expert committee headed by Sh G N Bajpai was set up in September 2014 to review the investment guidelines for the private sector for NPS. The report of the Committee has *inter alia* recommended introduction of new asset classes and instruments as one of the measures to optimise the returns to the subscriber. The report states that

*“The movement from the Directed investment regime to the Prudent investor regime shall entail not only easing of the ceilings for each asset class, but also allowing wider choice of instruments under each Asset Class across the board. This could mean expanding the universe of instruments under equity from merely mirroring any index to investing in securities with derivatives on the stock exchange and expanding into other capital market instruments ( primary and secondary) even further as the market matures, with suitable caveats and ceilings . In case of other asset classes ,it could mean introducing instruments like Covered notes , CPs/ CDs , SBLMs, Repo, Reverse Repo, CBLO, derivatives for the purpose of hedging etc again with suitable caveats and ceilings . It must be kept in mind that only such financial products be allowed which are exchange-traded, so that counter-party risk is eliminated, liquidity is enhanced and exchange-level regulation keeps a check on excess volatility. Progress can be reviewed after three years. This should be the phase when financial markets get ready to offer full basket of products for PFM to choose from”.*

Keeping this in view, it is proposed to allow the short lending of securities under the short lending borrowing ( SLB) Mechanism regulated by SEBI to optimise the returns to the subscriber.

## **2. What is SLB**

SLB is a legally approved medium for lending and borrowing of securities. The regulations were originally formed by SEBI in May 1997 and last modified in Nov 2012. All market participants including retail (except Qualified Foreign Investors) in the Indian securities market have been permitted to lend/borrow securities but only through an Authorized Intermediary(AI).

Securities Lending and Borrowing (SLB) is a scheme that has been launched to enable settlement of securities sold short. SLB enables lending of idle securities by the investors through the clearing corporation/clearing house of stock exchanges to earn a return through the same. Securities in the F&O segment are eligible for short selling.

NSCCL (NSE clearing corporation) and BOISL ( BSE clearing corporation) are the only 2 authorized intermediaries presently, NSCCL is preferred and is getting bulk of the transactions today.

As NSCCL is getting the bulk of the transactions, the SLB as operated by it has been discussed for clarity.

## **3. Features of Securities lending and borrowing scheme**

The clearing corporation of the National Stock Exchange of India (NSE) operates through a screen based exchange-traded system called SLB-NEAT. It has a centralized anonymous order book and all the borrowing and lending are cleared, settled and guaranteed. The expected lending fee is quoted as price and the tenures are available up to 12 months.

- Automated screen based trading platform with online matching of trades based on price- time priority
- Tenure of lending and borrowing available upto a period of 12 months
- A facility for placing early recall request for the securities lent is provided to the lender
- A facility for the borrower to make an early repayment of securities and further relend them
- The transactions are based on fixed monthly tenures with specified reverse leg settlement dates and the tenure ranges from 1 month up to 12 months. The specified reverse leg settlement date is the first Thursday of the corresponding month.

#### **4. Securities made available/permitted for SLB**

Presently securities on which derivatives are available in the F&O segment are available for transactions in SLB

#### **5. Participant in SLB**

Any existing member/custodian of CM segment can register as a participant in SLB.

#### **6. Settlement of SLB transactions at NSCCL**

NSCCL acts as a central counterparty providing financial settlement guarantee for SLB transactions. NSCCL collects adequate margins from participants to cover counterparty risks.

#### **7. Risk Management**

- (i). Position Limits: The applicable position limits for SLBS are as under:
- The market-wide position limits for SLB transactions is 10% of the free-float capital of the company in terms of number of shares
  - No Participant should have open position of more than 10% of the market-wide position limits or Rs. 50 crore (base value), whichever is lower
  - For a FII/MF, the position limits are the same as of the Participant
  - The client level position limits should not be not more than 1% of the market-wide position limits. All the applicable position limits applicable are computed on the last trading day of every month which will be applicable for the next month.

Note: No position limits are applicable to early recall/repayment transactions. However position limits are applicable to the original transaction till the successful completion of the settlement of early recall/repayment transactions.

- (ii). Collateral Deposits:

Participants may deposit collaterals in the form of cash equivalents i.e. cash, fixed deposit receipts and bank guarantee. The collateral deposited by the participant are utilized towards margin requirement of the participant.

In case of failure of the participant to meet its obligation, the collaterals provided by the participants may be liquidated by NSCCL to meet the obligation of the participant.=

(iii). Minimum Collateral

Every participant is required to continuously maintain minimum collateral of Rs.10 lacs in the form of cash as prescribed by NSCCL. This deposit should be provided by the participant at the time of registration in Securities Lending and Borrowing Scheme (SLBS).

(iv). Margins

All transactions under SLBS are subject to margins. Following margins are applicable for transactions under SLBS

**A. First Leg transactions**

The following margins are levied in respect of first leg of transactions under SLBS.

a. Borrow transaction

The borrower is levied only the Lending fee on T day.

b. Lend transaction

Lenders may bring in early pay-in of securities on the day of the transaction execution itself. In such cases no margins are levied on the lender.

The following margins are levied on the Participants for lend transactions till the time the pay-in of securities:

- Mark to Market Margins at EOD
- 25% of the Lending price

**B. Reverse Leg transactions**

a. Borrow transaction- Reverse leg

The borrower is levied margins in respect of reverse leg of transactions under SLBS. The following margins are levied on the Participants for a borrow transaction from T+1 to the reverse leg settlement day.

- Value at Risk Margins
- Extreme Loss Margins
- Mark to Market Margins
- Lending price

Lending price is collected in the form of cash or cash equivalents as prescribed by NSCCL. Borrowers may do an early repayment of securities in NSCCL's repayment account any time during the tenure of the borrowal period for availing of margin benefits.

b. Lend transaction- Reverse leg

The Lender would not be charged any margins for the reverse leg.

**C. Early Recall Transaction**

In case of early recall transaction the transacted lending fee for the recall transaction is levied as margin till the pay-in of lending fee the next day.

**D. Early Repayment Transaction**

There are no margins levied for early repayment transactions

**E. Value at Risk Margin (VaR Margin)**

- VaR margin rate as applicable to the security in the capital market segment are applicable in the SLBS.
- The VaR margin is collected on an upfront basis by adjusting against the collateral of the Participant at the time of transaction.
- The VaR margin is collected on the gross open position of the Participant. The gross open position for this purpose would mean the gross of all positions across all the clients of a Participant including its proprietary position.
- VaR margin rate for each security is disseminated to the Participants through the Extranet and on the website of the Exchange.
- The VaR margin so collected is released on completion of pay-in of the respective settlement.

**F. Extreme Loss Margin**

- Extreme Loss margin (ELM) rate as applicable to the security in the capital market segment is applicable in the SLBS.
- The Extreme Loss margin is collected on an upfront basis by adjusting against the collateral of the Participant at the time of transaction.
- The Extreme Loss margin is collected on the gross open position of the Participant. The gross open position for this purpose would mean the gross of all positions across all the clients of a Participant including its proprietary position.
- The Extreme Loss margin so collected is released on completion of pay-in of the respective settlement.

**G. Mark to Market Margin**

- Mark to market loss is calculated by marking each transaction in security to the closing price of the security at the end of day in the capital market segment. In case the security has not been transacted on a particular day in

the capital market segment, the latest available closing price at the NSE is considered as the closing price

- The mark to market margin (MTM) is collected from the Participant before the start of the SLBS session of the next day.
- The MTM margin is collected /adjusted from/against the collateral deposited by the Participant.
- The MTM margin is collected on the gross open position of the Participant. The gross open position for this purpose would mean the gross of all positions across all the clients of a Participant including its proprietary position. For this purpose, the position of a client would be netted across its various securities and the positions of all the clients of a Participant would be grossed.
- There would be no netting off of the positions and setoff against MTM profits across two settlements. However, for computation of MTM profits/losses for the day, netting or setoff against MTM profits would be permitted.
- The MTM margin so collected is released on completion of pay-in of the settlement.

#### **H. Exemption from margins in case of Early Pay-in**

In cases where early pay-in of securities is made prior to the securities pay-in, such positions for which early pay-in (EPI) of securities is made are exempt from margins.

#### **I. Custodial transactions**

In respect of transactions entered by a Participant which is to be settled by a custodian, the margins from the time of transactions till confirmation by the custodian are levied on the Participant. On confirmation of the said transactions by the custodian, the custodian is levied the margins applicable on such transactions. In case of rejection by the custodian, the margins on the transaction rejected continue to be levied on the Participant.

#### **J. Short fall of margins**

In case of any shortfall in margin the Participant is not be permitted to transact in SLBS with immediate effect. The same is considered as violation and would attract penal charges as may be specified by NSCCL from time to time.

#### **K. Margins from the Client**

Participants should have a prudent system of risk management to protect themselves from client default. Margins are likely to be an important element of such a system. The same should be well documented and be made accessible to the clients and NSCCL. However, the quantum of these margins and the form and mode of collection are left to the discretion of the Participants.

#### **L. Margin Shortages - Reverse leg**

In case the borrower fails to meet the margin obligations, NSCCL shall obtain securities and square off the position of such defaulting borrower, failing which there shall be a financial close-out.

#### **M. Lending price**

- Lending price refers to the previous day closing price of the security in the capital market segment i.e. T-1 day closing price in the capital market segment.
- 25% of the lending price is levied as margin on the Participants for lend transactions on T day. This is released on completion of pay-in of T+1 settlement.
- 100% of the Lending price is levied as margin on the Participants for borrow transactions starting from T+1 day till the shares are returned by the borrower.
- This is collected on an upfront basis by adjusting against the collateral of the Participant at the time of transaction.
- This is collected on the gross open position of the Participant. The gross open position for this purpose would mean the gross of all positions across all the clients of a Participant including its proprietary position.
- The margin so collected is released on completion of pay-in of the respective settlement.

#### **N. Lending fee**

- Lending fee refers to the actual price of the transaction at which the transaction is executed. Lending fee per share is quoted by the participants while entering in to SLB Transactions. Lending fee obligation is the lending fee per share\*quantity of shares borrowed/lent.
- For e.g. If a transaction is executed at Rs 5 per share for 100 shares of Security "X" then the total lending fee obligation for the borrower for security "X" will be Rs. 500.
- Lending fee is levied as margin on the Participants for borrow transactions on T day on an upfront basis.
- This is collected on an upfront basis by adjusting against the collateral of the borrower at the time of transaction.
- The margin so collected is released on completion of pay-in on T+1 settlement date.

#### **8. Clearing & Settlement**

- All Clearing members of NSCCL including Banks and Custodians referred to as 'Participant' are eligible to participate in SLBS. In order to participate in SLBS, clearing members have to register as Participants in SLBS.
- For this purpose, the eligible persons are required to follow the registration procedure as specified by NSCCL which includes entering into an agreement with NSCCL as per the format specified.

- Participants desirous of lending or borrowing securities can do so either on their own account or on behalf of their clients. Prior to undertaking lending or borrowing of securities on account of clients, the Participants are required to enter into an agreement with each client as per the format specified by NSCCL.
- The Participant need to apply to NSCCL for allotment of a "Unique client ID" for each client with whom they have entered into the agreement for participating in SLBS.
- The formats of Agreement between NSCCL & Participant and Participant & Client along with the procedure of UCI allotment to clients is available in SLB Circular NSE/CMPT/10164 (Ref. Circular No: NSCCL/SLBS/2008/002) dated January 30, 2008.

### **9. Eligible Securities**

- Currently, securities available for trading in F&O segment of National Stock Exchange of India Ltd. (NSEIL) are permitted.
- Securities lending and borrowing is permitted in dematerialized form only.
- Securities in which there are corporate actions are subject to either foreclosure of transactions or adjustment depending on the type of corporate action.
- The eligible securities for early recall/repayment are announced by NSCCL along with the list of eligible securities for SLB.

### **10. Period of lending**

- The tenure of lending and borrowing ranges from 1 month up to a maximum period of 12 months.
- Accordingly the return of securities by borrower is scheduled on the respective reverse leg settlement day. Each reverse leg settlement date is assigned a specific series number.

### **11. Early Recall facility for the Lender**

- In case the lender wants to recall the securities he has a facility to place a RECALL order on the order matching platform. The relend order should be for same series/security and for the same client. The lending fee for the balance period is at market determined rates hence the lender needs to quote the lending fee he wishes to forego for the balance period. The RECALL order can also be placed at market order.
- The lender can only enter a RECALL request if he has existing reverse leg positions. The recall request can be made for partial quantity.



- In case the early recall transaction is for a custodial participant, the custodian transaction has to be confirmed as per existing procedure for custodial transactions.

## 12. Early Repayment facility for the Borrower

- In case the borrower wants to repay the securities and further relend them, a facility to place a REPAY order is provided on the order matching platform. The relend order should be for same series/security and for the same client. The lending fee for the balance period is at market determined rates hence the borrower needs to quote the lending fee he expects for the balance period. The RECALL order can also be placed at market order. In case the early repayment transaction is for a custodial participant, the custodian transaction will be automatically confirmed by NSCCL and the securities transferred in NSCCL repayment account will be automatically utilized. Before the market places a REPAY order, the borrower has to first make an early repayment of securities in the repayment account prescribed by NSCCL.

## 13. Clearing:

All obligations are on a gross basis i.e. there is no netting of transactions. Where the participants have transacted for their client or on their own account the obligation arising out of such transactions will be on the Participant. However, where participants have transacted for a Custodial Participant (CP) client the transaction is subject to confirmation of the respective custodian and the obligation will be on the Custodians. However, non-confirmation of such transactions by the Custodian will revert the transaction to the participants obligation. Obligations for the first leg are downloaded to participants/Custodians on the T day and obligations for the reverse leg are downloaded on T+1 day.

- The first leg of the transactions across all series including early recall/repayment transactions are settled on T+1 day on a gross basis.
- Transactions under SLBS segment are identified based on different settlement types as intimated by NSCCL for the first leg and reverse leg settlements. Early recall and repayment transactions will be identified by separate settlement types in the obligation file.
- Early recall transactions would require custodial confirmation whereas early repayment transactions will be automatically confirmed by NSCCL.

**Lender's Obligation:** The lenders obligation is the securities lent on T day (Transaction date). The lender is required to deliver the securities by the scheduled time on T+1 day.

**Early Recall Obligation:** In case of early recall the lenders obligation is the lending fee which is transacted for the early recall transaction and is payable on T+1 day.

**Borrower's Obligation:** Borrower's obligation is the lending fees in cash form and the lending price (T-1 day closing price in the underlying security) in cash collaterals payable on T+1 day.

**Early Repayment Obligation:** The securities transferred by the borrower shall be automatically utilised toward the respective pay-in.

#### **14. Settlement Procedure**

The pay-in and pay-out of funds and securities is through the designated bank accounts and securities settlement account respectively. Transactions are settled on a T+1 day basis for the First Leg, Recall request & early repayment for all eligible series. Transactions are settled on reverse leg settlement date of the respective series.

#### **15. Designated Bank Account**

The bank account currently used by Participant for settlement of funds in the Capital Market segment is the designated bank account for giving effect to funds debits/credits under SLBS.

#### **16. Securities Settlement Account**

Participants are required to maintain accounts with both depositories i.e NSDL & CDSL. The pool account currently used by Participants in NSDL for effecting securities pay-in and pay-out in the Capital Market segment is used for settlement under SLBS.

In case of CDSL, Participants are required to open a separate settlement account for effecting securities pay-in and pay-out under SLBS.

#### **17. Client direct payout facility**

Participants / Custodians have been provided the facility of crediting the payout of securities directly to clients account. In order to avail of this facility, participant/custodian are required to provide a file in the specified file format available in SLB Circular (Ref. Circular No: NSCCL/SLBS/2008/001) containing details of the beneficiary accounts to which direct credit is to be given.

#### **18. Process of return of securities**

The borrowing Participants are required to return the securities borrowed on reverse leg settlement date of the respective series. The securities are returned to the lender of the securities by NSCCL on respective reverse leg settlement date of the series. In the case of borrower failing to return securities, NSCCL conducts an auction for obtaining securities. In the event of failure to procure securities in auction the

transactions are financially closed-out on the basis of the close-out computation formula.

### **19. Shortages and Close out**

- In the event of funds shortage by the borrower, the SLBS transactions are cancelled and the securities returned to the lenders along with lending fees.
- In the event the lender fails to deliver securities, the transaction is closed out as per the below procedure.

Higher of:

25% of closing price of the security on T+1 day (closing price for the security in the capital market segment of NSEIL), or

(Maximum trade price of the security in the capital market segment of NSEIL from T to T+1 day) - (T+1 day closing price of the security in capital market segment of NSEIL)

In the event the borrower fails to return the securities NSCCL conducts a buy-in auction in the Capital Market segment of NSEIL.

In the event of no offer in buy in auction/ failure to give delivery for offer in auction market on the settlement date, the transaction is closed out as per the below procedure.

Higher of:

The maximum traded price in the Capital Market segment of NSEIL from (reverse leg settlement date – 1day) to reverse leg settlement date, or

25% above the closing price of the security in the capital market segment on the reverse leg settlement date.

In all cases of shortages, NSCCL may initiate various actions including withdrawal of access to the order matching platform, withhold of the securities/funds pay-out due to the Participant or any other action as may be intimated by NSCCL.

### **20. Adjustment for Corporate Actions**

- All transactions in case of corporate actions other than dividend and Stock split will be foreclosed 2 days prior to ex-date.
- No Recall and Repay transaction is allowed in case of shorter tenure loans.
- In case of dividend, the dividend amount will be collected from the borrower by NSCCL and will be paid to the lender.
- In case of stock split, the position of the borrower would be proportionately adjusted and the lender will receive the revised quantity on the reverse leg settlement date.

- Adjustment of lending fees in case of foreclosure
- In case of corporate actions (other than Stock split & Dividend) all existing positions in SLBS are foreclosed two days prior to the Ex-Date. The lenders are required to repay proportionate amount of lending fees received from borrowers. The lending fees for the balance period shall be collected on pro rata basis from the lenders based on the lending fees received by them. The amount so collected shall be passed on to the borrowers in the ratio of their contribution to the pro rata lending fees receivable by them based on the lending fees paid by them. The lending fee will be brought by the lender on the foreclosure settlement date and will be passed on to the borrower.
- However in case of foreclosure where the corporate action is announced upfront by NSCCL before the transaction has been executed there will be no adjustment of lending fee. Market participants shall accordingly quote lending fee for the shorter transaction cycle.

## **21. Benefits for lender & who can be the lenders?**

It provides an incremental return on an idle portfolio. So if an investor intend to hold it for long term, in the shorter term I could lend this whenever there is a demand and get additional return in terms of lending fees/additional return knowing that NSCCL/BOISL are the guarantors.

Insurance companies, Banks, HNI, Mutual funds and Retail investors are currently participate in SLB as lenders.

## **22. Opportunity of SLB in NPS.**

- Pension Funds, invest the contributions received from NPS subscribers/APY subscribers of NPS /NPS under various schemes regulated/administered by Authority.
- The Assets (Securities against the investment of funds under separate scheme) are held in the name of NPS Trust (subscribers remains beneficiary owner) kept under custody of with Custodian (SHCIL) against the investments made in the market.
- Pension funds on behalf of NPS Trust execute/operate the market related activities, related to transactions/trade done, accordingly make payment from the bank accounts of scheme and ensures for completion of transactions.
- Since the horizon of investments made under various schemes of NPS are majorly long term, securities remains idle with the custodian (Equity shares under various schemes of NPS/APY) which can be further utilised to gain additional returns for NPS subscribers by lending securities as per above

mentioned process aligning with the procedure to execute the trade with NPS Trust , ensuring the below -

- Lending only part of (specific %age may be decided ) vis-a-vis total holding of the respective scheme
- benefits arising on such lent securities shall be made available to the subscribers rather the lender (pension fund) .
- Such lending will be permissible, subject to approval of Investment Committee.
- SLB will be permitted for equity only.
- Pension Fund can only lend the securities to the maximum extent of \_\_\_\_\_(%) in the respective/fund (or both)
- *SLB would not be treated as creating encumbrance, charge, hypothecation or lien on such securities.*
- The lending fee shall be accounted for on accrual basis in view of the risk of early repay/recall of securities.
- Securities under process of SBL process will be reported separately to the Authority/NPS Trust under the scheme portfolio.
- Other details of SLB (like reconciliation statement, name of scrip, no. of securities lent, name of fund, total quantity held, date of expiry of contract, value of securities lent as on date and Returns etc) shall be reported to Authority/NPS Trust on a periodic basis as decided by the Authority.
- The practices of lend , recall and repay etc. shall be make keeping the overall interest of subscribers .

Note: Comments may be offered vide e-mail on [sumeet.kapoor@pfrda.org.in](mailto:sumeet.kapoor@pfrda.org.in) or in hard copy to the below address-

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