First Metro Investment Corporation
Metrobank Group

Securities Borrowing and Lending (SBL)

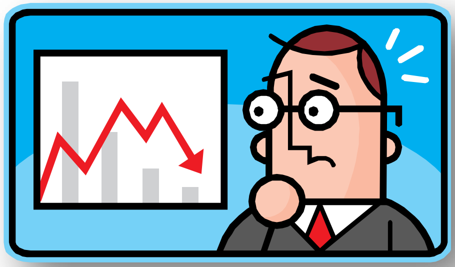
An Introduction

Two Ways to Profit in a Market (1)

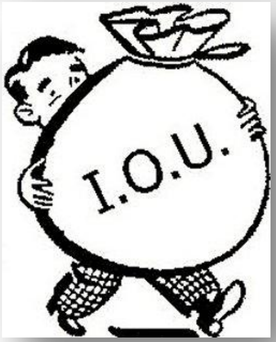
Profit from an Uptrend

Two Ways to Profit in a Market (2)

Investor anticipates a downtrend



Investor borrows securities in order to immediately sell them



Profit by selling the security and buying it back at a lower price

What is an SBL?

- It is the lending of securities from a lender's portfolio on a given date to support a borrower's trading activities

- Also known as **Securities Lending Transaction (SLT)**

Source: PSE SBL Program

How It Works

1. The Borrower loans a security from a fund.

2. The Lender receives collateral from the Borrower (in cash or equity/government securities) and gives the security.

How It Works

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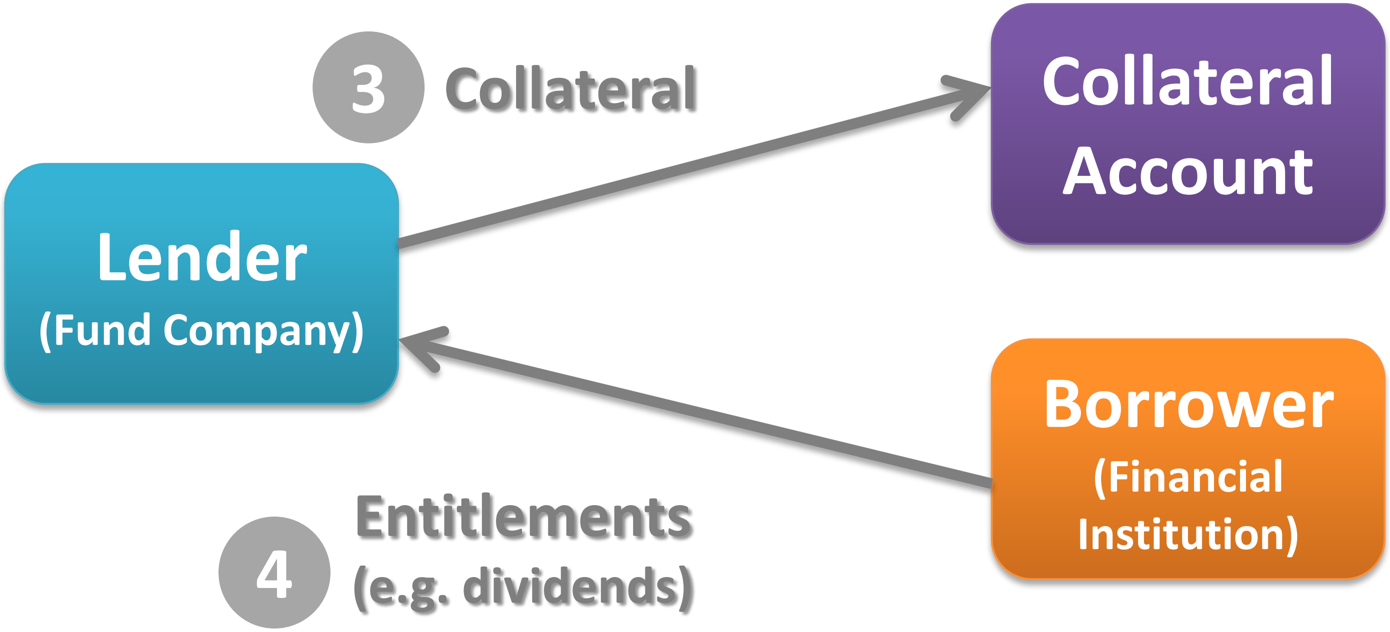
3. The **collateral** is held for the benefit of the fund, separately from the custodian’s and fund manager’s assets.

   - **Non-cash collateral** (equity/gov’t securities), the Borrower is charged a lending fee
   - **Cash collateral,** invested by the Lender in risk free financial instruments

How It Works

4. If the security pays dividends while it's out on loan, the financial institution pays the fund amounts equivalent to such income.



How It Works

5. At the end of the loan (or when the Lender requests), the Borrower must return the security back to the fund.
6. The fund then releases the collateral back to the Borrower.
7. Through the process, the fund generates additional income for shareholders.

Loanable Securities

- Securities listed in an Exchange
- Securities issued by the Bureau of Treasury or the Bangko Sentral ng Pilipinas

Source: PSE SBL Program

Lenders with Securities Portfolios of Sufficient Size

- Pension Funds
- Insurance and Assurance Companies
- Mutual Funds
- Unit Trusts
- Endowments

Lenders: Possible Routes to the Securities Lending Market

- Using an **asset manager** as agent
- Using a **custodian** as agent
- Appointing a **third party specialist** as agent
- **Auctioning** a portfolio to borrowers
- Selecting one **principal borrower**
- **Lending directly** to proprietary principals
- **Combination**

Borrowers

- Prime Brokers
- Hedge Funds
- Stockbrokers
- Banks
- Equity Traders

Benefits to the Market

- Hastens development in the capital market
- Facilitates investment and price stability
- Increased trading liquidity and investment alternatives
- Makes market more attractive to institutional and foreign investors

Source: PSE SBL Program

Reasons for Borrowing

- To avoid settlement failure
- To facilitate short selling
- To support derivative/arbitrage strategies
- To facilitate market making
- Naked shorting
- Financing
- Temporary transfers of ownership

Source: PSE SBL Program

Reasons for Lending

- Unlocks additional value of a portfolio
- Collects higher returns that would otherwise be received
- Offset management/custody fee
- Investors get better fund performance from generating income through fees for loaning securities
- Maximize portfolio return of long term holdings

Source: PSE SBL Program

Risks of SBLs

- **Credit risk -** the risk of loss in the event of defaults
- **Reinvestment risk -** the risk of having lower returns or earnings after reinvesting
- **Counterparty risk –** the risk on the return of securities borrowed and the lender’s income entitlements
- **Collateral risk –** the risk on the maintenance of the agreed value of the collateral vs. the loan’s market value
- **Mispricing risk -** the risk on overvalued collateral securities or undervalued lent securities
- **Liquidity risk -** the risk of illiquid securities to be realized at a lower price than the valuation used
- **Congruency** of collateral and lent portfolios
- Lack of **transparency**

Risk and Collateral Management Recommendations

- Regulatory principles for collateral reinvestment
- Objectives should emphasize the preservation of capital
- Provide more flexibility than money market funds
- Monitor the market by requiring disclosure thru non-public reporting of lenders and borrowers
- Indemnification should not be required but become part of the negotiation
- Internationally coordinated approach to standards and regulations

Insurance Commission Guidelines

- Borrowing period cannot exceed **two (2) years** from the date of execution
- Allowable collateral
  - Cash denominated in peso
  - Irrevocable and negotiable letters of credit issued by a commercial bank
  - Securities listed in the PSE
  - Securities issued by the Gov't of the Philippines
  - Any combination thereof

Insurance Commission Guidelines

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Type of Collateral	Security's Value Must be Maintained at
Cash or Letters of Credit	Not less than 102% of the current market value
Government Securities	Not less than 105% of the current market value
Equity Securities in the PSE	Not less than 130% of the current market value

Insurance Commission Guidelines

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Value of Collateral	Action
Less than the current market value of the borrowed securities	• Issue a margin call • Borrower shall promptly increase the amount of collateral to at least the current market value of the borrowed securities
Greater than the current market value of the borrowed securities	• Borrower may require the Lender to release the collateral which is in excess of the required current market value of the borrowed securities

Insurance Commission Guidelines

- Master Securities Lending Agreement (MSLA) or Multilateral MSLA
  - Specifies the **threshold level** above which the Borrower may require the release of excess collateral
  - The insurance/reinsurance company must obtain a **one-time authorization from the IC** per MSLA

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Thank you

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