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WEBINAR:

**INVESTING THROUGH THE
SECURITIES LENDING &
BORROWING SCHEME**

JUNE 16, 2021





TOPICS

- ☐ 1. Definitions
- ☐ 2. Who will participate in SLB?
- ☐ 3. Eligible securities
- ☐ 4 Collateral
- ☐ 5. Process flow
- ☐ 6. Early return of securities
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1. Definitions

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.

Definitions cont'd...

Lending fee

- Quoted price at which the lender want to lend their securities. This is calculated as a percentage of the value of the securities lent out.

SLB Lender commissions

- This is the commission amounts charged to lender and payable for SLB transaction. the commission is deducted from the lending fee.

SLB Borrower commissions

- This is the commission amounts charged to the borrower for the SLB transaction.

SLB Guarantee fund levy

- This is a levy charged by CDSC towards building up a guarantee fund to take care of lending fee in case of a failure by the borrower in settling the lender.

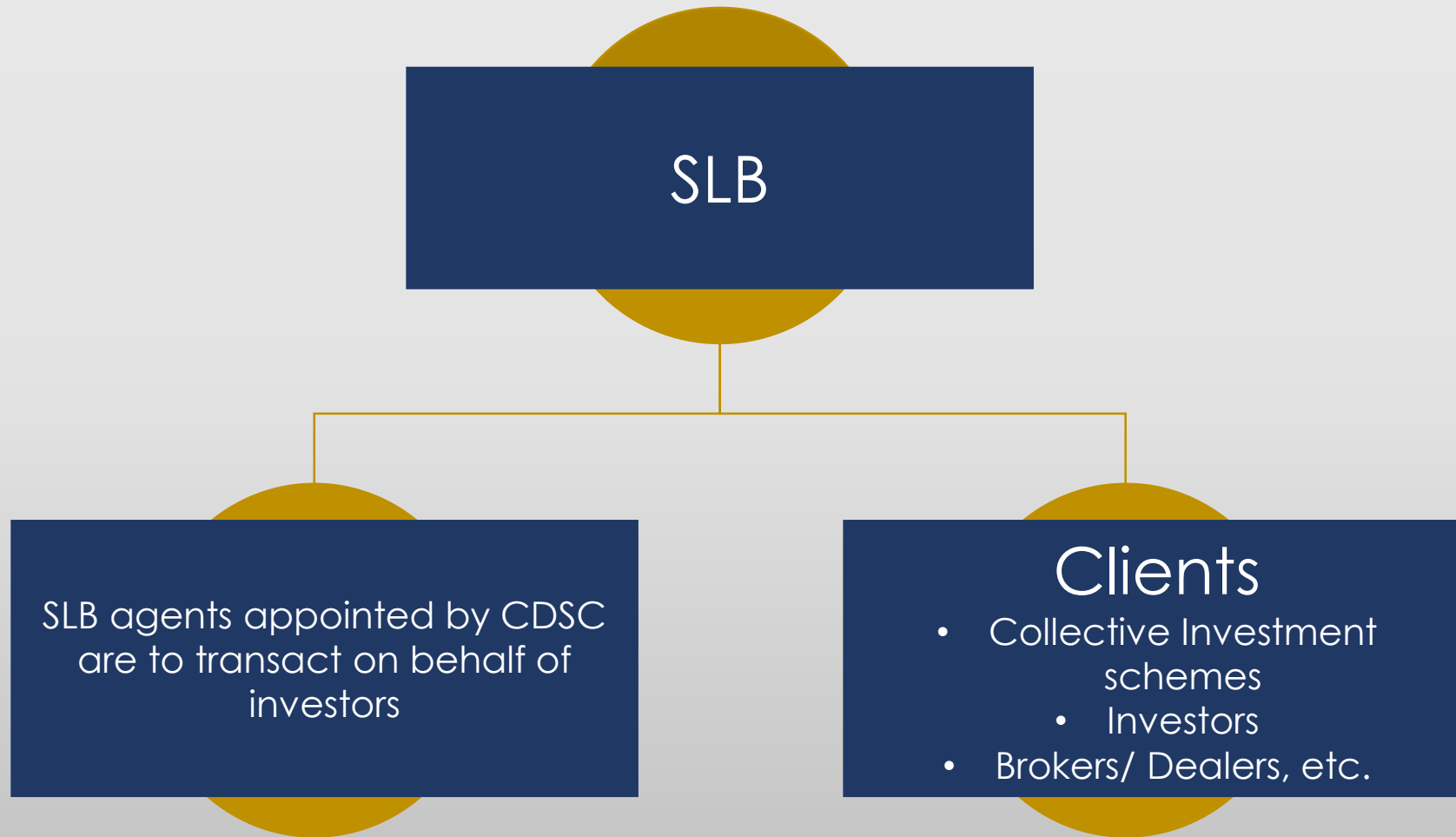
Collateral management fee

- This is a fee charged by CDSC to the borrower in managing cash collateral.

Call rate

- The rate earned on the cash collateral managed by CDSC.

2. Who will participate in SLB?



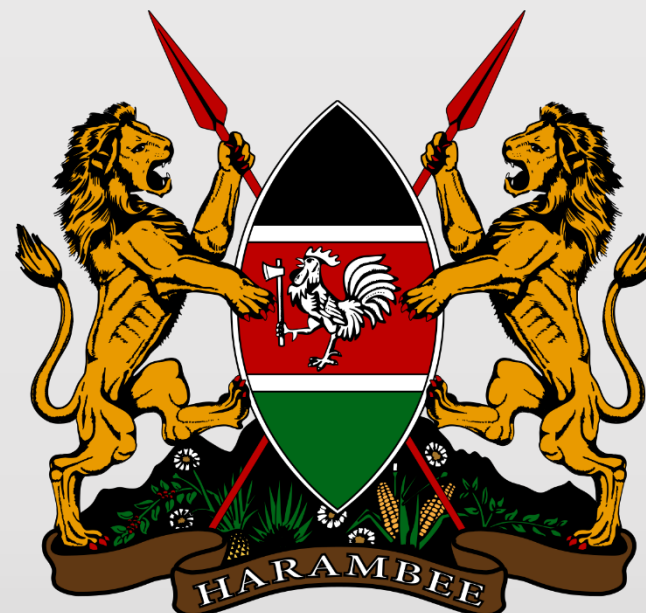
3. Eligible securities

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

4. Collateral



Cash



Government securities



Bank guarantee

Collateral cont'd...

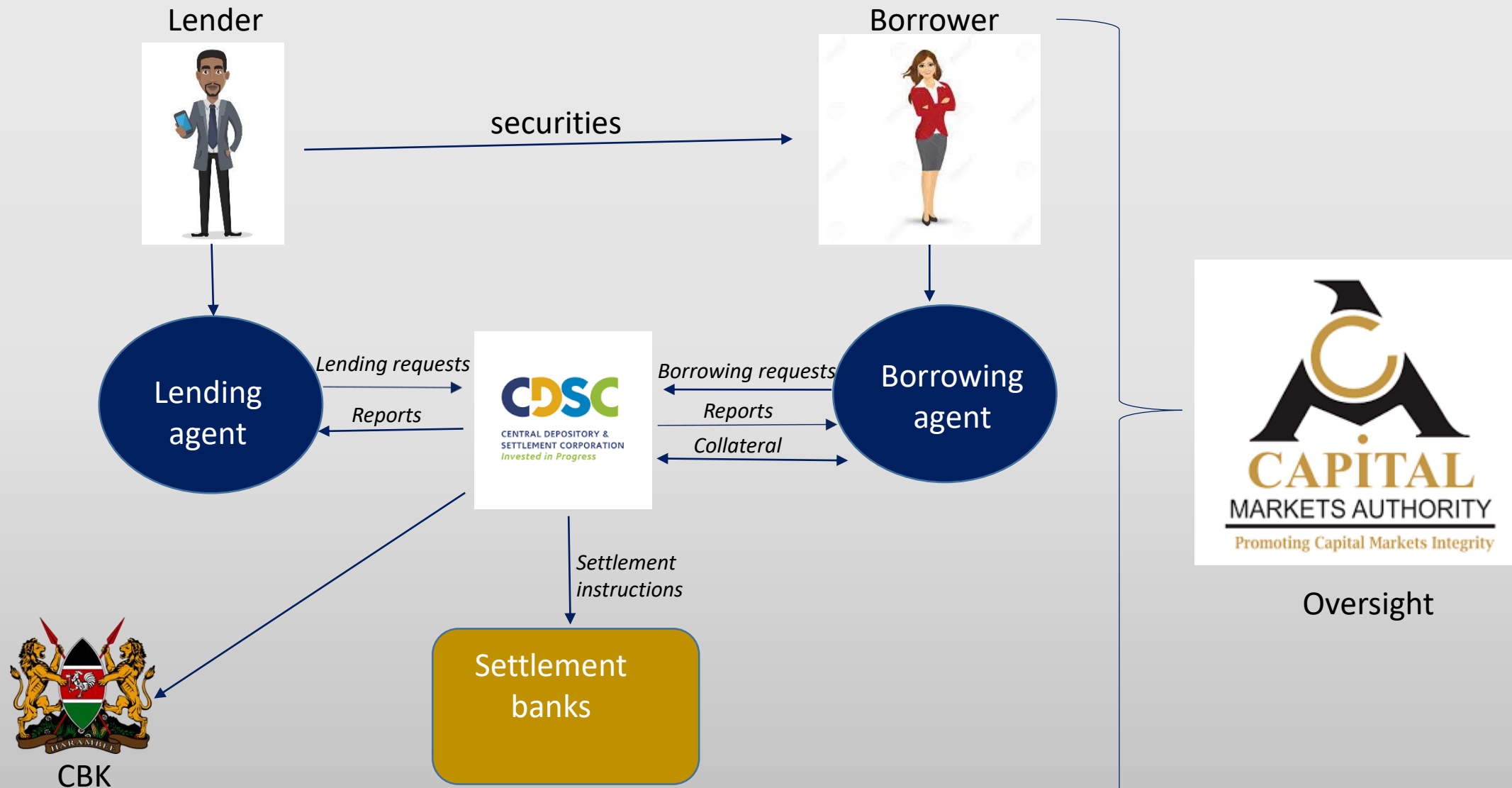
Collateral management

- 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 favour 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

5. Process Flow



Process flow cont'd...

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 CDSC account to the borrower's account and collateral is blocked.

6. Early return of securities

The lender has the option to recall securities earlier than the due date but will be required to give a 14 day notice.

The borrower will be able to return the securities earlier than the return date.

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.

7. Corporate Actions



Borrower to pay lender any dividends that accrue during the duration of the contract



Borrower to provide additional securities in case of a bonus or stock split



8. 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

9. Benefits

Benefits to the lender

- Additional income
- Lender doesn't have to look for borrowers in order to lend securities
- Lender doesn't have to manage the collateral since CDSC will perform this function
- Automated transfer of securities
- Lender will receive all corporate actions that take place during an SLB transaction
- No counterparty risk as transactions are guaranteed by CDSC

Benefits cont'd...

Benefits to the borrower

- Additional income
- 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
- Immediate automated transfer of securities ensures that borrowers receive securities in a timely manner
- No counterparty risk as transactions are guaranteed by CDSC

10. FEES

Lending Fee Rate - Market Determined

Lending SLB Commission and Levies = 16.0% of Lending Fees

Borrowing SLB Commission and Levies = 0.55% of Borrowed Value

Collateral Cover = 110%

Collateral Management Fee = 1%

10. Case examples

Example 1

If an investor was to lend 1 million shares trading at KES 38 at the NSE for a period of 90 days at a Lending Fee of 8% p.a.

BELOW IS AN ILLUSTRATION OF HOW THE **LENDER** WOULD MAKE MONEY:

- ❑ [Share Amount X Price] $(1,000,000 \times 38) = 38,000,000$
- ❑ [Lending Rate X Days/365] $(8\% \times 90/365) = 1.9726\%$
- ❑ $[(\$ \times P) (R \times D/365)] (38,000,000 \times 1.9726\%) = 749,588$
- ❑ SLB Lending Commission $(16\% \times 749,588) = 119,934$
- ❑ Net Lending Fee $= 749,588 - 119,934 = \text{KES } 629,654.00$

If lending period was one year, then the lending fee would be KES 2,553,600 net i.e. 6.7% p. a investment return FROM SHARES comparable to investing funds in fixed deposits earning 8% less WITHHOLDING TAX OF 15% TO EARN 6.8%

Example 1 cont'd

If an investor was to borrow 1 million shares trading at KES 38 at the NSE for a period of 90 days at a Lending Fee of 8% p.a.

❑ Borrowing Cost $[(1,000,000 \times 38) \times (8\% \times 90/365)] + [(0.55\% \times 90/365) \times 38,000,000]$

❑ Total Borrowing Cost: $(749,589 + 51,534) = \text{KES } 801,123$

BELOW IS AN ILLUSTRATION OF HOW THE BORROWER WOULD MAKE MONEY:

Should share price fall by KES 3 to KES 35 during the contract period

❑ $[\text{Share Amount} \times \text{Price}] (1,000,000 \times 35) = 35,000,000$

❑ Transaction Gross Profit $(38,000,000 - 35,000,000) = 3,000,000$

❑ Net Profit $= 3,000,000 - [801,123 + (\text{Transaction levies at NSE } (38,000,000 \times 1.8\% + 35,000,000 \times 1.8\%))]$

❑ Therefore Profit will be $3,000,000 - [801,123 + (684,000 + 630,000)]$

❑ Profit $= \text{KES } 884,877 + \text{interest earned from } 110\% \text{ cash collateral } (6\% \times 41.8\text{M} \times 90/365)$

❑ TOTAL RECEIVED $884,877 + 618,411 = \text{KES } 1,503,288$

Example 2

Assumptions

- Borrowing Date 3rd September 2020
- Return date 6th November 2020
- Number of days 65
- Security EABL
- Number of shares 100,000
- Lending rate 10%
- Share Price at borrowing 172.99
- Share Price at return 150.65
- Required Collateral + Margin (KES) = $17,299,000 + 1,729,900 = 19,028,900$

Example 2 cont'd...

Lender

Lender earnings

$$100,000 * 172.99 * 10 / 100 * 65 / 365$$

$$= \text{KES } 308,064.00$$

Lender expenses

$$\text{SLB Levies} = 16\% * 308,064.00 = 49,290.24$$

$$\text{Earnings} - \text{Expenses} = 308,064.00 - 49,290.24 = 258,773.76$$

Borrower

Borrower Earnings

Borrowed and sold 100,000 shares on 6th Nov 2020

$$@ 172.99 = 17,299,000$$

$$\text{Bought back shares @ } 150.65 = 15,065,000$$

$$\text{Difference} = \text{KES } 2,234,000$$

Example 2 cont'd...

Interest earned from cash Collateral = 5%*

$19,028,900 = 951,445 * 65 / 365 = 169,435$

Total Earnings = $2,234,000 + 169,435 = 2,403,435$

Borrower expenses

Commissions and levies at time of sale = $2\% * 17,299,000 = 345,980$

Commissions and levies at time of purchase = $2\% * 15,065,000 = 301,300$

Lending Fee paid to the lender = 308,064.00

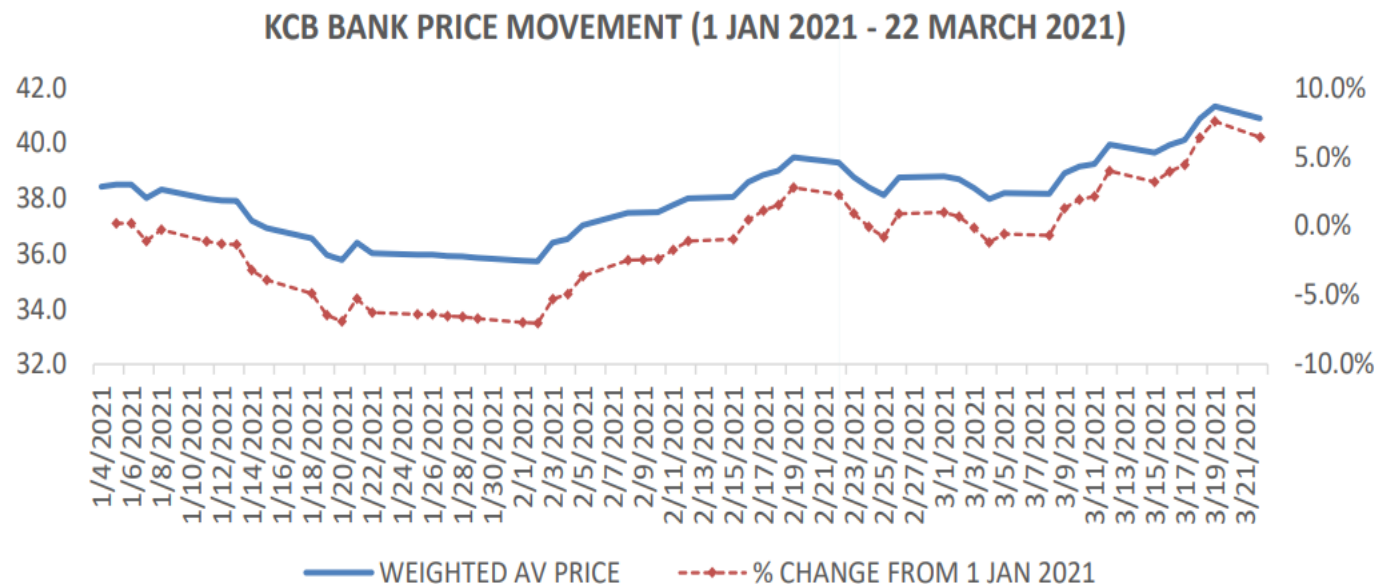
SLB Levies = $0.55 * 17,299,000 = 95,144.50$

Total Expenses = 1,050,488.50

- Difference between revenue and expenses = $2,403,435 - 1,050,488.50 = 1,352,946.50$

Example 3

KCB share performance



Borrowing Side

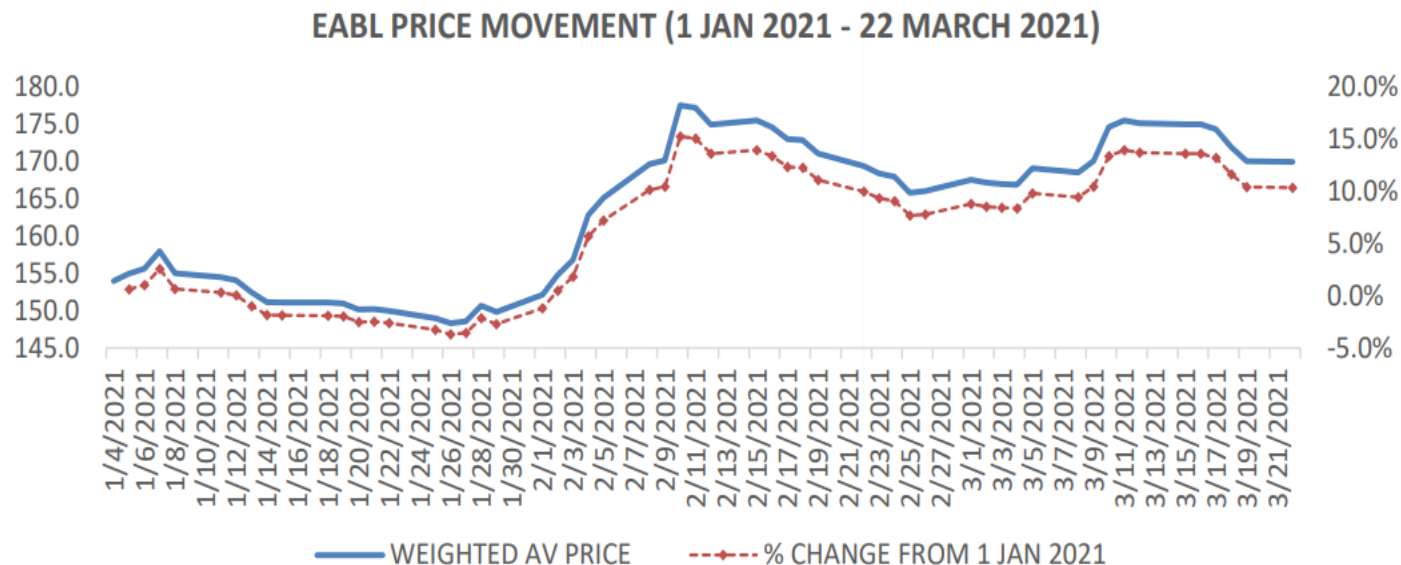
Units	1,000,000.00
Lending/Borrowing Rate (%)	8
Borrowing Date	05/01/2021
Return Date	04/02/2021
Borrowing Period (Days)	30
Borrowing Price	38.49
Return Price	35.72
Price Change	(2.8)
Gross Gain (KES)	2,772,429
Less: NSE Transaction levies	(1,335,824)
Less: Gross Lending Fee	(253,101)
Less: SLB Commission	(17,401)
Less: Corporate Actions	
Net Gain (KES)	1,166,103
Earnings From Collateral	208,808
Total Borrower Earnings (KES)	1,374,911

Lending Side

Units	Lending Rate (%)	Lending Date	Price at Lending Date	Lending Value	Return Date	Lending Period	Corporate Action	Net Returns (KES)
1,000,000	8	05/01/2021	38.5	38,492,429	04/02/2021	30		212,605

Example 4

EABL share performance



Lending Side

Units	Lending Rate (%)	Lending Date	Price at Lending Date	Lending Value	Return Date	Lending Period	Corporate Action	Net Returns (KES)
1,000,000	8	07/01/2021	158.0	158,000,000	26/01/2021	19		552,697

Borrowing Side

Units	1,000,000.00
Lending/Borrowing Rate (%)	8
Borrowing Date	07/01/2021
Return Date	26/01/2021
Borrowing Period (Days)	19
Borrowing Price	158.00
Return Price	148.36
Price Change	(9.6)
Gross Gain (KES)	9,642,677
Less: NSE Transaction levies	(5,514,432)
Less: Gross Lending Fee	(657,973)
Less: SLB Commission	(45,236)
Less: Corporate Actions	
Net Gain (KES)	3,425,037
Earnings From Collateral	542,827
Total Borrower Earnings (KES)	3,967,864

11. Risk management

Credit Risk

- Collateral to be maintained at 110% of the value of the securities borrowed.
- Daily mkt-to-mkt 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 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 NSE 20 index)
- The quality of the collateral required in a securities lending or borrowing transaction restricted
- 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 cont'd...

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

Operation 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

Q&A

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