

**AUSTRALIAN SECURITIES LENDING ASSOCIATION**

**CODE OF GUIDANCE**

**A S L A**

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## SECURITIES LENDING CODE OF GUIDANCE

This code drawn up by ASLA, an association of market practitioners, sets out, for guidance, a summary of the basic procedures which Australian based participants in securities lending observe as a matter of best practice. It is derived from current practices in the securities lending market and will be kept under regular review. The code does not in any way replace existing regulatory requirements or firms' internal systems of management control. Adherence to the code should therefore not be regarded as affecting the need for all participants to observe existing Australian regulatory requirements and to satisfy themselves independently that adequate internal controls are being exercised over all aspects of their participation in securities lending.

Please note that the words "lending", "borrowing", "collateral" and related expressions used in this code reflect market terminology only. Under Australian law, full title to securities "borrowed" or "lent" or "collateral" provided passes from one party to another, the party obtaining title being obliged to deliver back equivalent securities/collateral.

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### 1. **Regulatory Framework**

- 1.1. Participants should ensure that securities loan transactions are carried out in accordance with the relevant market and tax regulations.
- 1.2. All regulated participants should ensure that they have all relevant permissions from their regulatory authorities to undertake their part in securities lending transactions.

### 2. **Legal Basis**

- 2.1. All securities loan transactions should be subject to a written legal agreement between the parties concerned. Items in this code which should normally be covered by the legal agreement are asterisked (the legal agreement also contains other provisions outside the scope of this code).

- 2.2. Parties to a transaction should satisfy themselves that the legal agreement will allow their claims to be offset immediately against the claims of their counterparty in the event of default. Particular care will need to be taken in the case of agreements involving lending through an agent.
- 2.3. Where a custodian lends his client's securities there should be a clear legal agreement, which may form part of the standard custody agreement, authorising the custodian to lend securities, setting down the terms on which the securities may be lent and specifying the collateral that may be taken.

### **3. Authorities**

- 3.1.\* Participants should ensure that they have appropriate prior authority from the beneficial owners of the securities, or from a party suitably authorised by the beneficial owners, for the securities to be lent.

### **4. Counterparties**

- 4.1.\* Parties in a securities lending transaction should ensure that they are clear in what capacity their counterparty is acting; as principal, or agent, or agent taking principal risk.
- 4.2. In the case of an agent, the identity of the principal on whom the risk is taken should be established.
- 4.3. Parties in securities lending transactions should monitor their exposure to their counterparties on a daily basis.

### **5. Collateral**

- 5.1.\* Securities loans normally are made on a secured basis against collateral acceptable to the lender, as specified in the agreement or agreed by the parties prior to the loan.
- 5.2.\* The collateral should be delivered to the account of the lender or his agent or a designated third party.
- 5.3.\* The collateral taken should normally include a margin over the value of the loan; the margin should be specified in the agreement, or at the time of the loan if this is acceptable to both parties.
- 5.4.\* The loan and the collateral should be marked to market on a daily basis or as specified in the Securities Lending Agreement.
- 5.5.\* The agreement should provide for the collateral to be adjusted whenever there is a material change in the value of the currency or securities involved in the transaction and for the original margin to be restored.

- 5.6. All participants should take steps to ensure that daylight exposure is recognised and properly controlled: this should include controls on the replacement or renewal of collateral.
- 5.7. Where securities and collateral do not move within the same settlement system or country, particular care should be exercised to ensure that value for security is provided in a timely fashion to minimise daylight exposures and settlement/currency risk.

## **6. Distributions**

- 6.1.\* Arrangements should be made to compensate the lender of securities (or giver of collateral) for any dividend or interest payment due while a particular security is on loan (or collateral is held by the lender). These arrangements should make each party's obligations clear including, for example, the timing of any payments.
- 6.2. Participants should ensure that any franking credits (tax credits) due on dividends are properly accounted for in accordance with the relevant regulations.
- 6.3. Any Borrower of a stock which has voting rights, whether a final borrower or intermediary, should make it clear to the lender that voting rights have been transferred along with title to the stock.
- 6.4.\* The arrangements to be followed in the event of a rights issue or other 'situation' should be clearly established by all parties before a securities loan is made, with due recognition of local market practice.

## **7. Recall of Securities**

- 7.1.\* Parties should be aware of the procedure for recalling securities.: The rights and obligations of each party should be clearly established.
- 7.2.\* Any party wishing to return or recall securities on loan should notify its counterparty as soon as possible.
- 7.3.\* There should be explicit agreement between the parties on the arrangements to be followed if recalled securities cannot be delivered.

## **8. Failed Deals**

- 8.1. Parties should ensure that they are aware of the procedures to be followed in the event of failed deals in all markets in which securities is lent: The rights and obligations of each party should be clearly established.

## **9. Confirmation**

- 9.1. Borrowers should ensure that a written or electronic confirmation of each deal is issued.

- 9.2. Regular statements showing fees/rebates due/owed and outstanding balances of securities on loan and collateral given or taken should be produced and passed to counterparties.

## **10. Management Controls**

- 10.1. Appropriate exposure limits should be maintained for all counterparties and, whether part of a group limit or a solo limit for the party concerned, should be reviewed on a regular basis.
- 10.2. Clear records should be available to the management of any party involved in securities lending showing, the value of securities borrowed/lent, collateral given/taken and, where appropriate, any fee income received. This information should be available in aggregate and by counterpart to enable accurate monitoring of credit risk.
- 10.3. Parties should ensure that they have suitable internal controls to ensure that any securities loans have been properly authorised before stock is released for lending.
- 10.4. Management should maintain a list of those people in their office authorised to borrow or lend stock on its behalf and should make this list available to its counterparties on request.
- 10.5. Participants should take all reasonable steps to ensure that staff are fully informed of, and comply with, all laws, regulations and ethical standards applying to their activities in the market.
- 10.6. All participants share responsibility for maintaining the confidentiality which is essential for the operation of reputable and efficient markets.
- 10.7. Participants should comply with all aspects of standard market dealing procedure and market conventions for all market activities.
- 10.8. If viable, participants should exclude dealers from involvement in confirmations, settlements or accounting. Similarly, back-office staff must not be permitted to take part in the execution or management of deals. Separation of duties should be clearly stated.
- 10.9. Participants must be aware of the need to “know the client” and should endeavour to satisfy themselves that dealings are not used illegally to facilitate the concealment of illicit funds. Participants should ensure that staff understand the laws and regulations relating to the reporting of suspicious transactions.
- 10.10. The practice of tape-recording all conversations between participants and counterparties and with back-office confirmation and settlement staff is a common practice and is strongly recommended for participants.
- 10.11. When a dispute arises over a transaction, every effort to resolve it should be made by the staff involved. Where the disagreement cannot be resolved quickly, it must be referred to management. Participants should continue to pursue a prompt resolution, preferably without resort to legal proceedings.

10.12. Unauthorised use of computer software developed by an employer, or of file information dealing with the affairs of clients, may be a breach of copyright. Employers who leave a company are not permitted to take with them copies of the employer's computer programs or files or other records, unless otherwise agreed with the employer.

## 11. Market Terminology

11.1. Participants should always use clear and unambiguous language. They should familiarise themselves with the market's generally accepted terminology and definitions and be alert to any differences in interpretation of terms.

It should be noted that conversations take place at different levels and therefore care should be taken in communications with non-professional market participants to ensure that all details are clear and that market terminology does not lead to confusion.

### Some Generally Accepted Market Terminology

<b>Basis Point</b>	One hundred basis points is equal to one percent. This is the standard sub-division of a percentage used in the securities lending market.
<b>Buy-In</b>	A lender buying securities in the open market where the lender has recalled securities and the borrower is not able to return them in line with the securities lending agreement. All costs are normally borne by the borrower.
<b>Collateral</b>	Deposits of currency, financial instruments, or securities, that are delivered by the borrower to the lender to support a loan transaction.
<b>Daylight Exposure</b>	Where the movement of securities and collateral does not take place simultaneously, the first giver of assets has an exposure, called Daylight Exposure.
<b>Distributions</b>	Entitlements arising on securities, eg;. dividends, interest and non cash distributions such as bonus shares.
<b>Fee (1)</b>	The fee is the interest rate as charged by the lender and paid to the lender by the borrower on the value of the loan transaction.
<b>Fee (2)</b>	Can also be a payment from one party, either Borrower or Lender, to the other party and may not necessary relate to an interest rate or value of the loan transaction. Can also be called a levy.
<b>Fill or Kill</b>	See Holding Stock below.
<b>Haircut</b>	See Margin below
<b>Holding Stock</b>	also known as Icing, is the practice of reserving securities with a lender. The securities are still shown as available for loan by the lender. To other potential borrowers the lender must then show these securities as 'held away', and the 'holder' of stock retains rights of first refusal. Any other borrower can ask that the holder of stock either take or release the stock (called a fill or kill). If the holder declines to borrow the stock, the borrower

requesting the fill or kill must then borrow the stock. Holds generally apply for 24 hours but this will differ for each lender.

<b>Hot/Hard Stock</b>	A security for which demand to borrow is high relative to its availability in the market and hence becomes expensive to borrow.
<b>Manufactured Dividends</b>	When Securities that have been lent out pay a dividend, the borrower of the securities is required to pass on the distribution to the lender of the securities. This payment is known as the manufactured dividend or substitute payment.
<b>Margin</b>	Margin (also referred to as initial margin) refers to the excess of cash over securities or securities over cash in a securities lending transaction. One party may require an initial margin (haircut) due to the perceived credit risk of the counterparty or non cash collateral taken.
<b>Margin Call</b>	Margin Call refers to extra collateral repaid or paid due to changes in the value of stock borrowed.
<b>Mark to Market</b>	The act of re-valuing the securities and collateral to current market values.
<b>Rebate</b>	The rebate is an interest rate paid by the holder of cash to the counterparty of the transaction. Usually negotiated between the lender and borrower at the beginning of the loan.
<b>Recall</b>	A request by a lender for the return of securities by a borrower where they are lent on an open term basis.
<b>Repay</b>	Occurs when the borrower of securities returns them to the lender. Also known as a “Return”