



NSE

EQUITY



NSE

SLBM

SECURITIES LENDING & BORROWING MECHANISM

About Securities Lending & Borrowing (SLB)

Securities lending is a temporary lending of securities by a lender to the borrower. SLB is a very popular mechanism globally. This mechanism provides liquidity to the equity market and thereby increases the market efficiency.

In India, SLB is an Exchange traded product. NSE offers an anonymous trading platform and gives the players the advantage of settlement guarantee. It provides the lender and the borrower a secured platform to transact without the worries of counter party default.

In most other countries this product is an OTC (over the counter) product whereby the custodians facilitates the transaction of borrow and lend among institutions. It is a negotiated transaction between two parties in most countries. Thus, the lender has to deal with counter party risk, collateral adequacy, sufficiency risk, and other related risks.

Users & Usage of the product

Benefits to Lenders

- | Risk-free Income.
- | Protection of all rights as owner.
- | Settlement Guaranteed by NSCCL.
- | Low costs.
- | Potential to improve the portfolio performance.

Motivation for Borrowers

The reasons to borrow securities may vary among borrower like securities required to support a trading strategy, financing strategy or simply fulfilling a settlement obligation at the Exchange.

Some strategies where securities can be borrowed are listed below:-

- | **Cover short sale position:** Cover unintended short position created in the books.
- | **Arbitrage:** Sell securities short against an offsetting derivatives position to take advantage of dislocation between cash and derivatives markets.
- | **Pair Trading:** Buys the undervalued security and sell the overvalued security.
- | **Financing Transaction:** Trader borrows low volatility stock at lower price range and sells the same in the capital market segment. The amount earned is used in more profitable proposition to cover the incurred cost.

Reverse cash and carry arbitrage can be used in most of the situations discussed above. SLB market supports these strategies to fetch securities at a considerably low cost to deliver in the cash market.

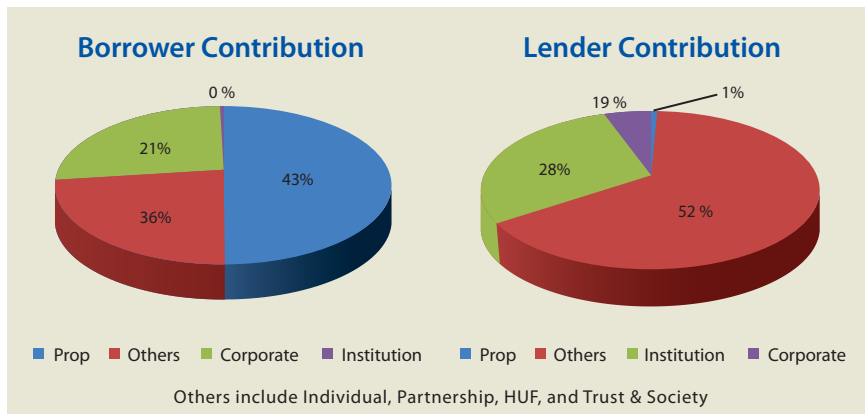
Regulations on Securities Lending & Borrowing (SLB)

SEBI has allowed all categories of investors including retail and institutional to borrow as well as lend securities. Since some entities are regulated jointly with other regulators their specific regulations are mentioned as under:

- **Foreign Portfolio Investor / Foreign Institutional Investor::**
 - | Lending allowed subject to FDI policy.
 - | Lending not permitted for shares in ban list /caution list of RBI.
 - | Borrowing allowed only for delivery into short sale.
 - | Margins to be paid only in the form of cash.
 - | Custodian to report short selling, lending & borrowing on a daily basis.
- **Mutual Funds:**
 - | Offer Document to disclose the intention to lend securities, exposure limit for the scheme as well as intermediary and market risk.
 - | AMC's to report to trustees on a quarterly basis about the level of lending in terms of value, volume and intermediaries; earnings/losses, and other details as may be required.
- **Insurance Companies:**
 - | Lending allowed to the extent of 10% of the quantity in the respective scripts in the respective fund. These limits must be adhered at all times.
 - | Securities lent in SLB not to be treated as creating encumbrance, charge, hypothecation or lien on such securities.
 - | Lending fees to be accounted on accrual basis.
 - | Lending allowed only after approval from investment committee.

Recent trends in lending & borrowing

- Historical data show that Retail & HNI players have been dominant players in the lending contribution followed by corporate and institutions.
- Proprietary players form a very large share in the borrower's pie.



NSE data from Apr'15 to Mar'16

Trading, Clearing & Settlement

Product Specifications

Particulars	Description
Platform	Automated screen based trading
Clearing	Settlement Guarantee by NSCCL
Market timings	9.15 am-3.30 pm (in line with Equities Market)
Order Types	Lend, Borrow, Recall & Repay
Trade Price (Quotes)	Lending Fees per Share
Tenures (Series)	12 Monthly contracts (*Rollover permitted)
Settlement	1st Leg: T+1; Reverse Leg: 1st Thursday of the month of the respective series
Last trade day	3 days prior to settlement day
Eligible Securities	All F&O securities + eligible Non F&O securities + Eligible Index ETF's

Recall & Repay Facility

Lender	Borrower
<ul style="list-style-type: none"> Permitted to recall before the expiry 	<ul style="list-style-type: none"> Permitted to repay before expiry
<ul style="list-style-type: none"> First step is to enter recall transaction in terminal at market determined rate 	<ul style="list-style-type: none"> First step is to make early repayment of securities to NSCCL A/c. Margin will be released instantly
<ul style="list-style-type: none"> Lender's TM need to specify it as "Recall" 	<ul style="list-style-type: none"> Borrower's TM need to specify it as "Repay"
<ul style="list-style-type: none"> Market will view the transaction as regular borrow transaction 	<ul style="list-style-type: none"> Market will view the transaction as regular lend transaction
<ul style="list-style-type: none"> Custody confirmation required 	<ul style="list-style-type: none"> Custody confirmation not required
Settlement of fee as well as securities happen on T+1 day	
On successful recall / repay, existing positions are closed & investors have no obligation to settle on expiry day	

*Roll over Features

It is allowed for a period of 3 months i.e the original contract plus 2 rollover contracts. No Further Rollover permitted after 2 months rollover. Rollover allowed only from positions in near month series. Last trading day of rollover contracts shall be 4th working day prior to expiry of respective near month series. In case of foreclosure, no rollover shall be allowed from or to the series getting foreclosed

Treatment of Corporate Actions

Corporate Actions	Fore-closure	Treatment	Action date
Dividend	No	Collected in cash from Borrower & passed to the Lender	Record Date +1
Stock Split	No	Outstanding position adjusted according to the split ratio	Ex-date
Bonus, AGM, Merger & Amalgamation	Yes	Proportionate lending fees collected from lender & passed to the Borrower	2 days prior to ex-date

Risk Management

Margins

Margins	T Day	T+1 Day	Reverse Leg
Lender	25% of Lending Price & MTM at EOD	Margins dropped on Settlement	No Margins
Borrower	100% of Lending Fees	100% of Lending Price, VaR, ELM & MTM at EOD	Margins dropped on Settlement

Margins are accepted in the form of Cash, Fixed Deposit, Bank Guarantee & Government Securities.

Position Limit

Position Limits	Security wise Applicable Limits
Market Wide (MWPL)	10% of the no. of shares held by non-promoters in the security
Participant Level	10% of MWPL or Rs. 500 mn whichever is lower
Institutional Investor (FII/ MF / Ins Cos. / PFI / Banks / PFs)	10% of MWPL or Rs. 500 mn whichever is lower
Client level (Excl. the ones mentioned above)	1% of MWPL

- Position limit for SLB is considered for entire month.
- The list is provided through circular "Applicable MWPL, Participant, Institutional Client & Non-Institutional Client Limits for Securities and ETFs – SLBS" issued on last working date of previous month.

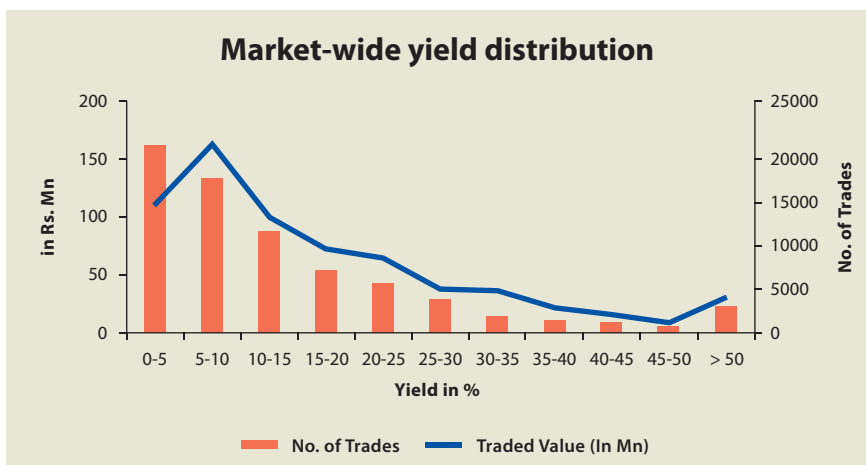
Shortage Handling

Shortages	Type	Action taken
First leg	Security Shortage by Lender	No Funds payout to Lender. Financial close-out on T+1 @ min 25% of T+1 closing price of security
First leg	Fund Shortage by Borrower	No Securities payout to Borrower. Lending fee recovered from borrower & passed onto the Lender along with Securities
Reverse Leg (RL)	Security Shortage by Borrower	Valuation Debit to Borrower on RL day Followed by Auction on same day along with Cash Segment Auction settlement/ close-out on RL +1

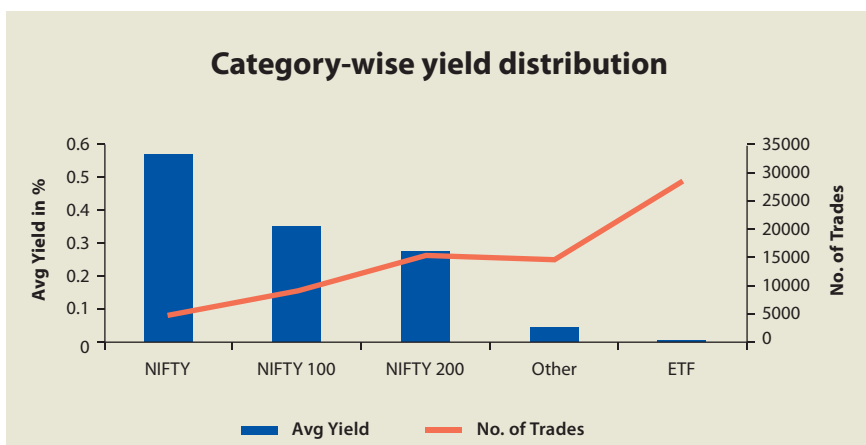
Recent Yield Trends

- Yield in any market is an indicator of the potential profits to be gained in the market.
- Formula for the yield calculation:

$$((\text{Lending Fees} / \text{Notional Turnover}) * (365 / \text{Time to expiry})).$$



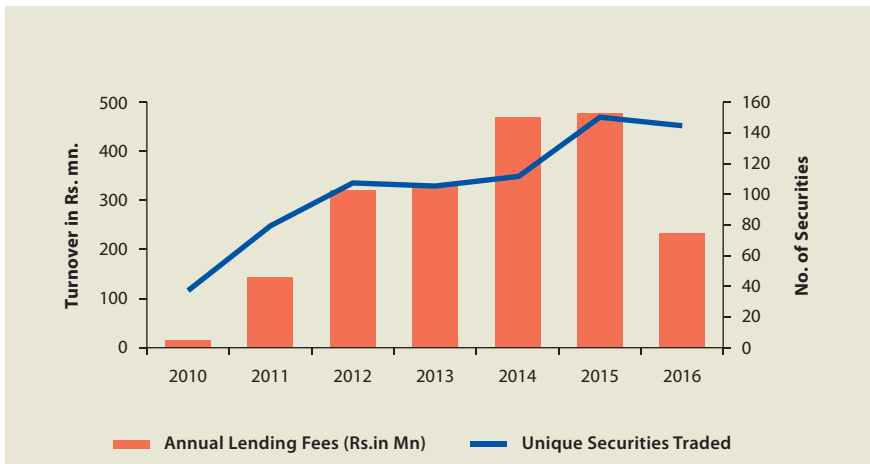
Trade wise data plotted from Apr'15 to Mar'16



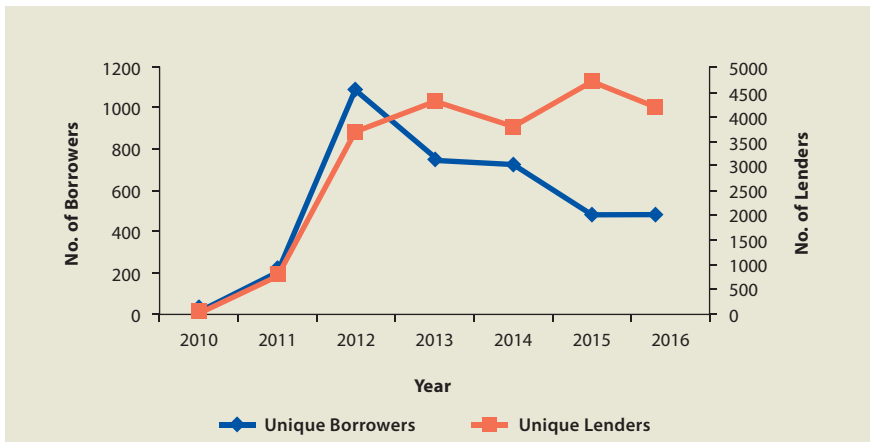
Trade wise data plotted from Apr'15 to Mar'16

Growth in SLBM Business

- Growth in the product is not limited to few parameters but in various parameters.
- This reflects that the product is moving from the introduction stage to the growth stage in the product lifecycle.



Source: NSE Data



Source: NSE Data

Example of Cash Future Arbitrage

- When Future price is lower than cash price, trader can buy future and sell cash
- If the trader does not hold shares in his books, he can borrow the shares on T day or latest by T+1 day from SLB and deliver on the cash market payin day
- On the FO expiry or before, when the Cash & FO prices are nearest to convergence, trader can buy shares in Cash market and close the FO position
- Then trader can return the shares purchased at the SLB expiry
- Return expected is the difference between the Cash & future price minus the transaction cost in CM & FO & the borrow cost of SLB

Security : BHEL
 Qty in shares : 100,000
 15-Sep-14 (T) : Sell Cash & Buy Future
 16-Sep-14 (T+1) : Borrow in SLB
 17-Sep-14 (T+2) : Deliver shares borrowed in SLB for cash market payin

Borrower's P&L

Buy in Futures	21800000	
Short Sell in Cash Market		22100000
Gross Profit		300000
Regulatory Charges		
<i>Cash Market Charges</i>		
Exchange Turnover Charges	1436.50	
SEBI Turnover Charges	88.40	
Securities Transaction Tax	4420.00	
Stamp Duty	884.00	
<i>F&O Market</i>		
Exchange Turnover Charges	828.40	
SEBI Turnover Charges	87.20	
Securities Transaction Tax	3706.00	
Stamp Duty	872.00	
Total Regulatory Charges	12322.50	
SLB Borrow Cost	100000.00	
Net Profit		187677.50

* Assuming this is a proprietary trade where brokerage is zero and margin cost is also zero

Lender's Yield

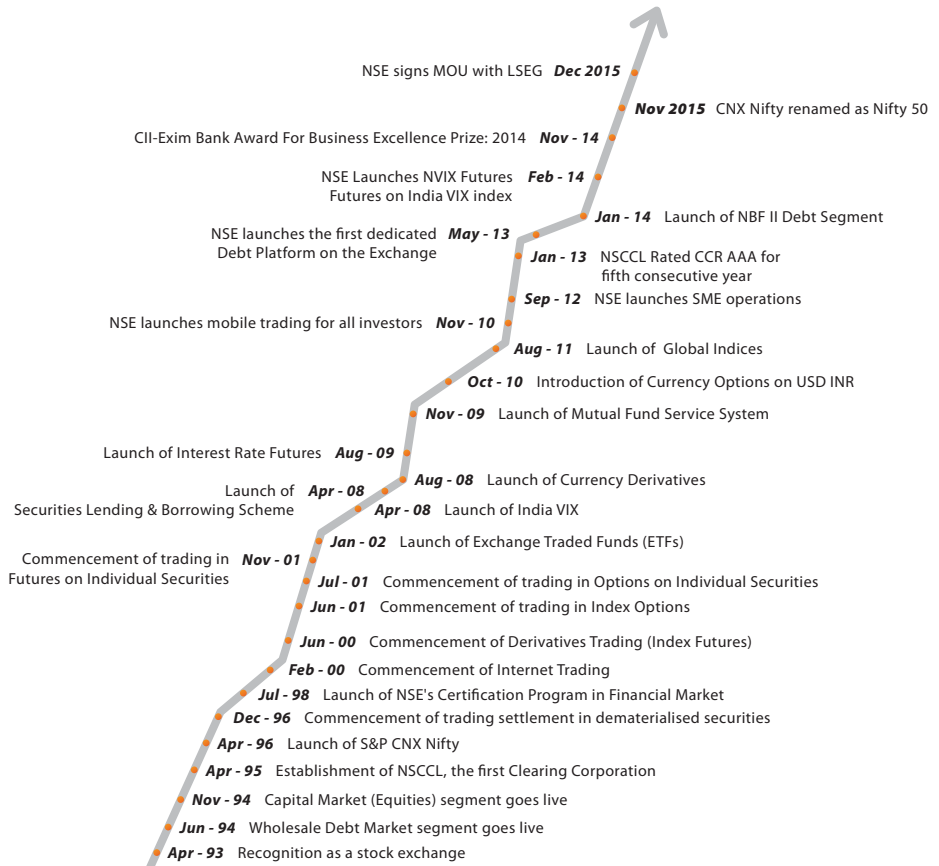
- In the above example lender also gains an advantage by lending
- Lender earns yield to the tune of 7.86% per annum

Trade Value	Notional T/O	Time to expiry	Yield
100000	22100000	24	7.86% p.a.

About NSE

NSE is one of the leading exchanges in the world on several key parameters. NSE is ranked number one exchange in terms of number of trades in equity markets. It also has the highest number of contracts traded in stock index options and exchange traded currency derivatives. NSE uses state-of-art information technology to provide an efficient and transparent market mechanism. It has heralded several innovations like demutualisation; screen based trading, reduced settlement cycles, dematerialization, electronic-transfer of securities, robust risk management systems and introduction of clearing corporation to take on counterparty risks.

Milestones



Contact

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