Republic of the Philippines
SECURITIES AND EXCHANGE COMMISSION
SEC Building, EDSA, East Greenhills
Mandaluyong City, Metro Manila
Tel: (632) 726-0930 to 39 Website: www.sec.gov.ph

SEC MEMORANDUM CIRCULAR NO. 7
Series of 2006

SUBJECT: RULES ON SECURITIES BORROWING AND LENDING

WHEREAS, Section 2 of the Securities Regulation Code (SRC) declares that it is the policy of the State, among others, to promote the development of the Philippine capital market;

WHEREAS, Section 28 of the SRC provides that no person shall engage in the buying and selling of securities in the Philippines unless such person is registered to engage in said activity, by the Commission;

WHEREAS, securities borrowing and lending (SBL) is a form of securities business activity regulated by the Commission;

WHEREAS, Section 39 of the SRC mandates that the Commission registers and grants licenses, supervises and regulates organizations engaged in activities related to or connected with the securities business;

WHEREAS, Sections 33.2 (l) and 42.2 (e) of the SRC require the transparent, prompt and accurate clearance and settlement of all securities transactions;

WHEREAS, the framework for SBL facility must be institutionalized principally because it facilitates the settlement of securities transactions, broadens trading strategies for market participants and enhances liquidity in the market;

WHEREAS, the SRC likewise mandates the Commission to regulate the extension and maintenance of credit on securities;

WHEREAS, the SRC authorizes the Commission to issue rules and regulations to make effective the provisions of the SRC;

NOW, THEREFORE, pursuant to the foregoing provisions of the SRC, the Commission hereby adopts and issues the following rules to govern securities borrowing and lending activities.

Section 1. Coverage - These rules prescribe the requirements for the conduct of SBL transactions by brokers, dealers, banks, insurance companies and other persons or entities which may be engaged or involved in SBL transactions.

Section 2. Definition of Terms - The following terms shall have the meaning indicated, unless the context provides otherwise:

(a) **Beneficial Owner** refers to any person who, by way of any contract, arrangement or other means, is entitled to the rights of ownership over a security including the power to vote or to direct the voting of said security and the power to dispose of or to direct the disposition of said security. In the context of securities, this term is generally used to distinguish this party from the legal owner *(eg, a nominee)* who holds the securities for the beneficial owner.

(b) **Borrower** refers to a person who borrows securities from a lender's portfolio in order to support his trading activities.

(c) **Borrowing Period** or **Lending Period** refers to a specified period agreed upon by the parties during which the SBL transaction remains outstanding.

(d) **BIR** refers to the Bureau of Internal Revenue of the Republic of the Philippines.

(e) **Collateral** refers to cash or property with ascertainable value permitted under these rules to be used as security for borrowed securities for the period until the borrowed securities are returned or paid.

(f) **Commission** refers to the Securities and Exchange Commission of the Republic of the Philippines.

(g) **Direct Lender** refers to an entity that lends, by way of formal loan agreement, its own securities directly to the borrower and not through an intermediary or lending agent. The direct

lender is either the beneficial owner or legal owner of the securities subject of loan.

(h) **Equivalent Securities** refer to securities of a similar type or class of issue bearing the same securities identification number and under the same tax regime as the borrowed securities that are transferred to the borrower.

(i) **Exchange** refers to any entity registered with the Commission as an exchange pursuant to the SRC.

(j) **Intermediary** refers to a third party institution that facilitates the SBL transaction.

(k) **Lender** means a person who lends securities from his own portfolio or from the assets of his clients by way of formal loan agreement. A lender may be a direct lender or a lending agent.

(l) **Lending Agent** means a juridical person which acts on behalf of a client with respect to the lending of securities.

(m) **Manufactured Dividend or Payment** refers to the dividend or coupon payment or any payment in respect to any corporate action of the issuer which is created to compensate a lender of securities or a borrower with respect to the collateral used for security, for any dividend or payment that accrues while the securities are on loan to the borrower or the collateral is held by the lender.

(n) **Margin Call** refers to the notice issued to the borrower to increase the amount of collateral to cover the amount of the outstanding borrowed securities.

(o) **Margin Release** refers to the act of releasing to the borrower of the excess collateral.

(p) **Mark-to-Market (MTM)** means the practice of periodically valuing borrowed securities and securities used as collateral based on their current market prices in order to reflect their current market value.

(q) **Master Securities Lending Agreement (MSLA)** refers to the agreement between the lender and the borrower that embodies the terms and conditions by which securities are lent or borrowed.

(r) **Securities Borrowing and Lending (SBL)** means the lending of securities from a lender's portfolio on a given date to a borrower's portfolio to support the borrower's trading activities with the commitment of the borrower to return or deliver said securities or equivalent to the lender on a determined future date. This is also referred to as a Securities Lending Transaction (**SLT**). Notwithstanding the use of expressions such as "borrow", "lend", "loan", "return", "redeliver", in SBL transactions, title to securities "borrowed" or "lent" shall pass from one party to another, and the party obtaining such title is obliged to redeliver or return equivalent securities.

(s) **Securities Custodian** refers to a juridical entity that performs the functions of safekeeping securities for clients, holding title to the securities as nominee, valuing securities, administering dividend, reporting and other services.

(t) **Securities Lending Authorization Agreement (SLAA)** refers to the contract between the beneficial owner of securities and his agent by which the former authorizes the latter to offer his securities for lending under the terms agreed between them.

Section 3. Modes of Conducting SBL: Lending Agent; Direct Lending – Securities lending may be conducted by the beneficial owner directly or through a lending agent; *Provided that*, the parties to a SBL transaction shall comply with the documentation, valuation, collateral management, settlement, record keeping, reporting, accounting standard and other requirements as prescribed by the Commission.

Securities lending may also be done using other methods such as through lending pool system, competitive auction, bid offer transaction or other schemes subject to the evaluation and approval of the Commission; *Provided that*, the parties to a SBL transaction shall comply with the required documentation, valuation, collateral management, settlement, record keeping, reporting, accounting standard and other requirements.

Section 4. Registration Requirements for Lending Agent. No person shall act as lending agent unless he is registered as such by the Commission.

An applicant for registration as lending agent must submit to the Commission the following:

a. Duly accomplished Application Form.
b. Board Resolution/ Authorization from applicant company/ firm allowing the securities lending agency service.
c. Organizational and functional charts of the securities lending unit.
d. Names and Curriculum Vitae of securities lending unit personnel.
e. Detailed description of automated Securities Lending System.
f. Manual containing risk management and internal control procedures.
g. Copy of *Bangko Sentral ng Pilipinas* (BSP) license if the applicant is accredited securities custodian for banks and non bank financial institutions under BSP supervision.

In addition to the above, the applicant, upon filing of the application, must pay a registration fee in the amount of Php 50,000.00 and must furnish the Commission a copy each of the pro-forma MSLA and SLAA he intends to use, for record purposes.

The Commission from time to time may prescribe other requirements it may deem necessary. Such requirements shall be applicable to all lending agents including those authorized before the adoption thereof.

Section 5. Requirements for Securities Lending Unit Personnel – The securities lending unit personnel of the lending agent must demonstrate to the satisfaction of the Commission that its personnel possess functional knowledge and sufficient technical expertise in the operation of the securities lending system.

Section 6. Requirements for Securities Lending System – The securities lending system of a lending agent shall have the following minimum basic functions and capabilities:

a. Provide price quotation, trade matching and confirmation services.
b. Run a lender selection process if necessary.
c. Deliver the borrowed securities to the account of the borrower.
d. Receive collateral securities from borrower.
e. Perform daily valuation of borrowed and collateral securities.
f. Determine the adequacy of total collateral value against the total market value of borrowed securities outstanding for each borrower.
g. Issue margin calls or effect margin releases as appropriate.
h. Track corporate actions on borrowed and collateral securities, collect the benefits due them and distribute said benefits to the lender or borrower as the case maybe.
i. Execute loan and collateral return and recall processes.
j. Receive borrowed securities from the borrower on maturity date.
k. Return collateral to the borrower at the end of borrowing period or earlier.
l. Collect lending fee on agreed due date and distribute the same to the lender.
m. Inform borrower of the occurrence of default.
n. Report failed settlements.
o. Monitor foreign ownership of equity securities.

The lending agent may appoint a third party to perform any or all the foregoing functions; *Provided that*, the lending agent shall disclose in its application for registration, its engagement of a third party service provider; *Provided further that*, the lending agent shall be accountable for the acts, errors and omissions of such third party service provider.

Section 7. Requirements for Direct Lending – Only the following institutions may engage in direct lending: (1) domestic banks and branches of foreign banks; (2) investment houses; (3) investment companies; (4) insurance companies; (5) pension funds or retirement plans maintained by the Government of the Philippines or managed by a bank or other persons authorized by the *BSP* to engage in trust functions; (6) securities dealers, and;

(7) other entities that may be declared by the Commission as qualified to engage in direct lending.

The direct lender may lend its own securities directly to a borrower; *Provided that,* the parties shall comply with the following:

1. The direct lender and borrower must execute an MSLA;

2. The direct lender must have a securities lending system which is capable of performing any or all of the functions enumerated under Section 6 hereof, and shall use the same to execute the SBL.

The direct lender may appoint a third party to perform any or all the functions enumerated under Section 6; *Provided that*, such engagement of a third party service provider shall be disclosed to the borrower prior to the execution of MSLA; *Provided further that*, the direct lender shall be accountable for the acts, errors and omissions of such third party service provider.

Section 8. Execution of MSLA - Prior to the execution of the first SBL transaction under a particular MSLA, the parties concerned shall execute an MSLA.

The MSLA shall contain, among others, provisions on the following:

a. The capacities in which the parties are acting.
b. Term of loan and manner of confirmation.
c. Mode of and requirements for delivery of borrowed securities.
d. Eligible collateral and delivery of collateral.
e. Statement that there is absolute transfer of title over the borrowed securities.
f. Collateral management procedures.
g. Valuation of securities.
h. Arrangement for dealing with manufactured dividend, payment, voting right and corporate action.
i. Return and recall of securities and consequences.
j. Events of default and remedies of parties.
k. Grounds for termination of loan and rights of parties upon termination.

l. Lending fee and other charges.
m. Representations and warranties of the parties.
n. Liability of parties.
o. Dispute resolution.

The MSLA must be assigned a reference number. If BIR registration is necessary, the MSLA must be registered with the BIR.

Section 9. Execution of SLAA – Prior to the delivery of securities by the beneficial owner to the agent, they shall execute an SLAA which must stipulate their respective rights and obligations on account of the lending of securities.

The SLAA shall contain, among others, provisions on the following:

a. Appointment of the agent by the beneficial owner and the acceptance by the agent of such appointment.
b. Scope of agent's authority with regard to administration of the borrowed securities and collateral.
c. Scope of agent's services and functions.
d. Qualified borrowers, investment managers, investment outlets, if any.
e. Eligible collateral and collateral management terms, if any.
f. Grounds and requirements for termination of agency.
g. Lending fees and other charges.
h. Representations and warranties.
i. Liability of the parties.
j. Dispute resolution.

Section 10. Loanable Securities – Only securities listed in an Exchange and securities issued by the Bureau of Treasury or the *Bangko Sentral ng Pilipinas* are eligible for lending under SBL transaction; *Provided that*, such securities are in electronic form or if certificated, the same must be in its electronic form at the time of SBL transaction and free from all liens and encumbrances.

The Commission may allow other securities for lending under SBL transaction.

Section 11. Delivery of Borrowed Securities - The borrowed securities shall be delivered to or deposited with the borrower simultaneous with or after the delivery of the collateral. The borrowed securities shall be deemed delivered by the lender on delivery to the borrower or upon the lender's direction in the instrument of transfer.

If the borrowed securities are being held by an agent, custodian, depository or within the clearing and settlement system, such borrowed securities shall be deemed delivered by the lender on the effective instruction to such agent, custodian, depository or operator of such clearing and settlement system which delivery shall result in such borrowed securities being held for the account of the borrower or by such other means as may be agreed.

In case of securities the title of which is registered in a computer-based system that provides for the recording and transfer of title by way of book entries, transfer of title shall take place in accordance with the rules of procedure of such system.

The parties shall execute all necessary documents and give all necessary instructions to ensure that the title, rights and interests in the borrowed securities shall pass from one party to the other.

Section 12. Eligible Collateral - For every borrowed security, the borrower shall provide the lender adequate collateral that may consist either of cash, equity or government securities, or a combination thereof, or other forms of collateral that may be allowed by the Commission.

The eligible collateral securities are those securities listed in an Exchange, securities issued by the Bureau of Treasury or the *Bangko Sentral ng Pilipinas*; *Provided that*, such securities are in electronic form or if certificated, the same must be in its electronic form at the time of SBL transaction and free from all liens and encumbrances.

Section 13. Delivery of Collateral - Cash collateral shall be delivered or deposited to the account of the lender prior to or simultaneous with the delivery of the borrowed securities.

The collateral securities shall likewise be delivered to or deposited with the lender prior to or simultaneous with the delivery of the borrowed securities. Collateral securities shall be deemed delivered by the borrower on delivery to the lender or upon the borrower's direction in the instrument of transfer.

If the collateral securities are being held by an agent, custodian, depository or within the clearing and settlement system, such collateral securities shall be deemed delivered by the borrower on the effective instruction to such agent, custodian, depository or operator of such clearing and settlement system which delivery shall result in such collateral securities being held for the account of the lender or by such other means as may be agreed.

In case of securities the title of which is registered in a computer based system that provides for the recording and transfer of title by way of book entries, transfer of title shall take place in accordance with the rules of procedure of such system.

If the parties intend that the title, rights and interests in the collateral securities shall pass from one party to the other, they shall execute all the necessary documents and give all necessary instructions to effect such transfer of title.

Section 14. Marking to Market; Valuation; Margin Call; Margin Release - The borrowed and collateral securities must be marked-to-market at least once daily based on the valuation method as indicated by the parties in the MSLA. In the absence of such agreement, valuation shall be based on current market price.

The value of the collateral must be maintained at levels agreed upon by parties; *Provided however, that*, in the absence of such agreement, the value of the collateral shall be maintained at an amount not less than the prescribed market value of the securities borrowed.

If the collateral or the borrowed securities are in the form of cash or government securities, the value of collateral must be maintained at an amount not less than 102% of the current market value of the securities borrowed.

If the collateral or the borrowed securities are in the form of equity securities, the value of collateral must be maintained at an amount not less than 105% of the current market value of the securities borrowed.

When the value of collateral becomes less than the current market value of the borrowed securities, a margin call must be issued and the borrower shall promptly increase the amount of collateral to at least the current market value of the borrowed securities.

However, when the value of collateral becomes greater than the current market value of the borrowed securities, the borrower may require the lender to release the collateral which is in excess of the current market value of the borrowed securities. The parties shall specify in the MSLA the threshold level above which the borrower may require the release of excess collateral.

The margining may be done on an aggregated or loan by loan basis; *Provided that*, the margining method to be adopted by the parties shall be specified in the MSLA.

Section 15. Reinvestment of Collateral – The cash collateral shall be invested in the manner consistent with the terms disclosed at the time of the execution of the MSLA. The terms of reinvestment of cash collateral shall include: (a) list of qualified investment outlets; (b) list of qualified financial institutions; (c) criteria for considering an investment; (d) procedures for selecting an investment; (e) agreement on fees; and, (f) period or term of investment that must be not longer than the term of the particular SBL transaction.

The reinvestment of cash collateral shall at all times comply with the applicable rules and regulations of the *BSP*. The Exchange, as regards their trading participants who are engaged in SBL transactions, may provide additional requirements on reinvestment of cash collateral or disallow the same.

Section 16. Substitution of Collateral – Within the borrowing period, the borrower may withdraw the collateral upon prior notice to the lender; *Provided that*, the borrower shall substitute the withdrawn collateral with another eligible collateral

acceptable to the lender. In such case, the lender shall return to the borrower the original collateral as demanded by the borrower.

Section 17. Recall of Borrowed Securities – Within the borrowing period, the lender may recall the borrowed securities upon prior notice to the borrower in accordance with the standard settlement cycle for such securities. In such case, the borrower shall return the borrowed securities or their equivalent as demanded by the lender. On the other hand, the lender shall pay back the amount of cash collateral and return the collateral securities or their equivalent provided by the borrower.

The borrowed or collateral securities shall be deemed returned by one party on the delivery to the other or upon the party's direction in the instrument of transfer.

The causes by which the lender may recall the borrowed securities as well as the consequent rights and obligations of the parties on account of such recall shall be provided in the MSLA. The MSLA must also contain provisions that would ensure that recall rights are not exercised indiscriminately. However, the lender and the borrower may agree that the borrowed securities shall not be recalled during the borrowing period.

Section 18. Return of Borrowed Securities – Within the borrowing period, the borrower at any time may return the borrowed securities or their equivalent to the lender. When the borrowed securities or their equivalent have been returned, the lender shall pay back the amount of cash collateral and return the collateral securities or their equivalent provided by the borrower.

The consequent rights and obligations of the parties on account of such early return of borrowed securities shall be provided in the MSLA.

The borrowed or collateral securities shall be deemed returned by one party on delivery to the other or upon the party's direction in the instrument of transfer.

Section 19. Termination of Loan – At the end of the borrowing period, the borrower shall return the borrowed securities or their equivalent to the lender. On the other hand, the lender shall pay back the amount of cash collateral and return the collateral securities or their equivalent provided by the borrower.

The borrowed or collateral securities shall be deemed returned by one party on delivery to the other or upon the party's direction in the instrument of transfer.

Section 20. Default of Parties - The lender and borrower shall provide in the MSLA the circumstances constituting events of default on either party, their remedies and their consequent rights and obligations in case of default.

Section 21. Restriction on Foreigners – Foreigners shall not borrow from Filipinos equity securities of Philippine companies which are engaged in nationalized activities and whose foreign ownership is limited by the Constitution and existing laws unless there is in effect an established mechanism or process by which foreign ownership in said companies can be properly monitored so as to ensure that foreign equity remains within the constitutional and statutory limitations.

Lending agents and direct lenders shall ensure that SBL transactions entered into by foreigners are properly accounted for and that such foreigners agree to comply with these rules and applicable regulations.

Section 22. Documentation of SBL Transaction – Each SBL transaction shall be covered by a confirmation notice that specifies the details of the SBL transaction. The confirmation notice shall, among others, contain the following information: reference number, contract date, names of lender and borrower, type and quantity of borrowed securities, term, delivery date, face amount and market value of borrowed securities, collateral, MSLA reference number and settlement date.

Each party to the SBL transaction shall be entitled to receive a copy of such confirmation notice.

The Commission may allow other forms of confirmation notice and the information to be included therein.

Section 23. Record Keeping and Reporting -- Lending agents and direct lenders shall maintain SBL ledgers, whether in manual or electronic form, that must be kept up-to-date and must contain the full and complete details of all SBL transactions.

The ledgers shall contain data such as the names of lender and borrower, tax information numbers of parties, contract date, type and quantity of borrowed securities, term, delivery date, face amount and market value of borrowed securities, collateral, MSLA reference number, settlement date, returned and unreturned borrowed securities and such other data the Commission may deem necessary.

Lending agents and direct lenders may also maintain other books and records containing details of their SBL transactions.

The ledgers, books and records pertaining to SBL transactions shall be subject to periodic or special examinations by examiners and other authorized representatives of the Commission. These ledgers, books and records shall be maintained in accordance with Section 52 of the SRC.

Lending agents and direct lenders shall submit to the Commission a bi-annual Summary Report of their SBL transactions within thirty (30) days after the end of the covered period.

The Commission may allow a different manner of compliance with the record keeping and reporting requirements prescribed in these rules taking into account the different modes of conducting SBL.

Section 24. Authority of the Exchange – The Exchanges licensed by the Commission to operate may design and adopt their own SBL programs and prescribe their own rules to govern the securities borrowing and lending activities of their trading participants; *Provided that*, said SBL programs and rules shall be consistent with the regulations herein set forth and approved by the Commission.

Trading participants of an Exchange shall conduct their SBL transactions in accordance with the rules of the Exchange concerned.

Section 25. Compliance With BIR Regulations – For an SBL transaction to qualify for tax exemption, the parties thereto must comply with the requirements imposed by the BIR under the applicable revenue regulations.

Section 26. Prohibition and Penalties - The Commission may disallow any securities from being lent or borrowed, limit the ability of borrowers to borrow eligible securities or impose additional restrictions on borrowers it may deem necessary for the protection of investors.

Any person who violates any provision of these rules shall be penalized as follows:

VIOLATION	AMOUNT OF FINE
1st Violation	Php 20,000.00 for every order/transaction or twice the amount of order/transaction, whichever is higher.
2nd Violation	Php 30,000.00 for every order/transaction or twice the amount of order/transaction, whichever is higher
3rd & Subsequent Violations	Php 50,000.00 for every order/transaction or twice the amount of order/transaction, whichever is higher.

The imposition of the monetary penalty shall not prejudice the filing of administrative and criminal charges as may be warranted by circumstances against persons responsible for the violation.

Section 27. Effectivity - These rules shall take effect fifteen (15) days after publication in two (2) newspapers of general circulation.

Mandaluyong City, June 9, 2006.

For the Commission:

EE B. BARIN
Chairperson

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