



MEMORANDUM

No.2010-0074

The Philippine Stock Exchange, Inc.

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| <input type="checkbox"/> Trading Rules | <input type="checkbox"/> Computer Systems Update |
| <input type="checkbox"/> Membership Fees | <input type="checkbox"/> Administrative Matters |
| <input type="checkbox"/> Listing Fees | <input checked="" type="checkbox"/> Others: <u>SBL Guidelines</u> |

DATE : 19 February 2010

SUBJECT : PSE's Guidelines on Safeguards Against SBL Violations and Expected Minimum Response by Trading Participants

Please be advised that the PSE's Guidelines on Safeguards Against SBL Violations and Expected Minimum Response by Trading Participants has been recently approved by the Securities and Exchange Commission. Attached is a copy of the said guidelines.

The Guidelines will take effect on March 5, 2010. Market Regulation Division will issue a separate Memorandum for Trading Participants for the amendment of their Written Supervisory Procedures (WSP).

For your information and guidance.

ENRICO M. TRINIDAD
Vice President
Capital Markets Development Division



PART 2 – SAFEGUARDS AGAINST SBL VIOLATIONS AND EXPECTED MINIMUM RESPONSE BY TRADING PARTICIPANTS

These guidelines identify the possible violations, among others, that may be committed by trading participants as regards the PSE Rules on Securities Borrowing and Lending (SBL). These guidelines also provide the relevant safeguards and expected minimum response by the trading participants to address the violation of the SBL rules.

- A. (1) **Failure to Share Lending Fees to Beneficial Owners of Securities Lent**
(2) **Unauthorized Lending of Clients' Securities**
(3) **Breach of Foreign Ownership Limitation**

The following are the applicable safeguards to minimize and address the above violations:

1.01 System Requirements and Transaction Monitoring

All participants acting either as principal or agent shall determine and ensure that they have the adequate systems and procedures to perform the settlement, reportorial and documentation requirements for the effective management of the risks associated with SBL transactions. These should include, but not be limited to, the following items:

- (a) establishing, retaining and periodically updating their documentation to comply with the requirements of the applicable laws and regulations and these Rules;
- (b) periodically reviewing the agreements to determine if terms and conditions still apply;
- (c) suitable internal controls designed to ensure that any Securities lent have been properly authorized before they are delivered to the Borrower;
- (d) clear and timely records; and
- (e) access to information on the actual percentage of foreign ownership of all Securities in the SBL transactions, in order to avoid breach of foreign ownership limitation.

(incorporated in sections 4.1 and 4.2 of the MSLA, and in sections 4, 16.3, 22, and 30 of the Multilateral MSLA)

1.02 Documentary Requirements

A Trading Participant acting on behalf of its client shall warrant and undertake under oath, that it unconditionally represents and continues to represent having entered into a duly-executed SLAA or a prior agreement in substantially the same form as the SLAA with its client, and that it agrees to be liable in case of breach of representation in such undertaking. The SLAA shall define, among others, the terms and conditions on the following:

- (a) clients'/beneficial owners' right to cash/stock dividends, stock rights, and other corporate actions; and

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- (b) clients'/beneficial owners' right to receive a specified rate or amount representing the fee/income from the lending transaction.

The Trading Participant shall warrant and undertake under oath that its reports to the Exchange are clear, timely, true, correct, and reflect all Securities Borrowing and Lending transactions at the end of every six months, and that such reports shall show, among others, the following:

- (a) the value of the Securities borrowed or lent;
- (b) the composition of the Securities borrowed or lent; and
- (c) fee or income received arising out of the SBL transaction.

The Trading Participant shall also submit a report to the Exchange within fifteen (15) calendar days after the end of every six months that there are no Securities Borrowing and Lending transactions if such is the case.

A Trading Participant shall warrant and undertake in its MSLA that it shall have a valid, binding and enforceable SLAA or any other equivalent agreement, in accordance with SEC rules and regulations. The Client Account Information Form or the CAIF is not considered as the equivalent agreement of the SLAA.

(incorporated in sections 6, 7, 10.6, 12, and 13 of the MSLA, and in sections 10, 11, 12, 13, and 16 of the Multilateral MSLA)

- B. (1) Failure to Appropriately Manage Collateral Received Resulting to Loss of Possible Income**
- (2) Requirement of Unreasonably Large Value of Collateral**

The following are the applicable safeguards to minimize and address the above violations:

2.01 System Requirements and Transaction Monitoring

- (a) The following critical activities performed by the Lending Agent should be considered by the Trading Participant/Agent-Facilitator for dissemination to their client, whenever applicable:
- (i) marking-to-market of Securities lent vis-à-vis the Collateral;
- (ii) recording and distribution of cash dividends, rights, and other corporate actions;
- (iii) investment and management of cash collateral; and
- (iv) reporting requirements for tax and other regulatory purposes.

(incorporated in sections 5.4, 5.5, 7.2, 6, and 11 of the MSLA, and in sections 7.5, 7.7, 10, and 30 of the Multilateral MSLA)



2.02 Collateral and Risk Management

- (a) A daily "mark-to-market" valuation method for the Collateral must be in place to ensure that margin calls and release of excess Collateral, as agreed by the parties, are made on a timely basis.
- (b) All Lenders/Lending Agents must have clear guidelines as to the type of Collateral to be accepted, taking into account factors that may affect the value of the Collateral.
- (c) All participants shall be alert to possible settlement risks and take steps to ensure that exposure is minimized and properly controlled.
- (d) When a Trading Participant/Agent Facilitator acts as an agent for more than one Lender, a system should be in place for determining the amount of Collateral received by the particular Lending Agent/s on behalf of each client, and for determining the amount each client is entitled to in case of Borrower's default.

The Trading Participant shall execute an undertaking under oath, in favor of the Exchange, that the terms and conditions on collateral management as provided for under the MSLA are complied with.

(incorporated in sections 5.4, 5.5, and 9 of the MSLA, and in sections 4, 7.2, and 7.5 of the Multilateral MSLA)

- C. (1) **Failure to Properly Distribute Dividend (Manufactured Dividend) and Other Corporate Entitlements**
(2) **Denial of Beneficial Owners' Right to Vote**

The following are the applicable safeguards to minimize and address the above violations:

3.01 Corporate Actions

- (a) The rights of each party should be defined in the MSLA and SLAA, in case of any corporate action or any merger, dissolution, insolvency, etc., affecting the borrowed Securities and Collateral involved in the SBL;
- (b) All Lenders/Lending Agents shall have, among others, a Securities Lending System, as provided for in Section 6 of the Securities and Exchange Commission SBL Memorandum Circular, to be able to monitor and allocate voting rights, dividend payments, stock rights distribution, and any other corporate action to the beneficial owners. In line with this, all arrangements to be followed in the events of a rights issue or other corporate action may be established by all the parties before the Securities are lent, with due recognition of applicable laws and regulations, rules of the Exchange, and any deadlines imposed by the various parties' local agents or custodians.
- (c) Lenders must be made aware that if they lend their entire holding of a particular Security, they may cease to receive information about corporate events in relation to it. Lenders should take steps to ensure that they are able to access information on the Security lent.

(incorporated in sections 4 and 6 of the MSLA, and in sections 10 and 16 of the Multilateral MSLA)

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***Right to Vote on the Securities
Right to Recall Securities***

- (i) A Trading Participant shall communicate effectively to the Lenders and Borrowers that SBL transactions involve the absolute transfer of title to the Securities lent and, unless otherwise agreed to by the parties, any voting rights are transferred along with the title. Once the Securities have been passed, the new owner of these Securities has the right to sell or lend them to another and vote in shareholder meetings if they are the holder on record date.
- (ii) A Trading Participant who borrows Securities from its own clients, whether as the final Borrower or Agent-Facilitator, aside from engaging the services of a Lending Agent, shall put the Lender on notice that any voting rights will be transferred along with legal title to the Securities and that the Lender will therefore not be exercising his/her rights until those Securities are returned to him/her, unless a written proxy or voting trust is executed in accordance with law.
- (iii) Lender shall be notified of his/her right to recall equivalent Securities from the Borrower in order to vote. The Lender recalling the Securities may provide the Lending Agent or Borrower with a period of no less than the standard settlement cycle upon prior notice to the Lending Agent or Borrower.

The Borrower who fails to redeliver the equivalent Securities upon recall shall be deemed to be in default, and the SBL transaction shall be treated as a deemed sale in accordance with section 9 of BIR Revenue Regulations No. 1-2008.
- (iv) The Lender or Lending Agent must communicate to the Borrower the Lender's position with regard to voting. The Lending Agent or Trading Participant must have strong operational procedures in place to ensure that recalls are made where appropriate.

(incorporated in sections 4.2, 6.3, 8.2, 8.4, 9, 12, 13, and 14 of the MSLA, and in sections 6.2, 10.3, 13.1, 13.2, and 17 of the Multilateral MSLA)

A Trading Participant shall warrant and undertake, under oath, that it unconditionally represents and continues to represent having entered into a duly-executed MSLA, and that it agrees to be liable in case of any breach of the representations and the terms and conditions of the MSLA.

A Trading Participant shall warrant and undertake, under oath, that it shall comply with all the applicable laws, rules and regulations of the Securities and Exchange Commission, the Bureau of Internal Revenue, and the Exchange.

The Trading Participants must also update its written Supervisory Procedures Manual to identify any abuses relative to the Securities Borrowing and Lending transactions and to put in place the necessary safeguards to address such abuses.

(incorporated in section 16 of the Multilateral MSLA)



Sanctions

a. Grave Violations

1. Engaging in SBL without a duly-executed and registered MSLA;
2. Unauthorized lending of clients' securities without a duly-executed SLAA or exceeding the authority under the SLAA;
3. Execution of naked short selling;
4. Failure to return borrowed securities;
5. Breach of foreign ownership limitation.

b. Major Violations

1. Failure to update and keep all books, records and documents required in the conduct of SBL;
2. Failure to share the lending fees to the beneficial owners of securities lent;
3. Failure to manage collateral received;
4. Failure to properly distribute dividend (manufactured dividend) and other corporate entitlements;
5. Denial of beneficial owners' right to vote, unless agreed otherwise.

c. Minor Violations

1. Failure to comply with the submission of the following PSE reportorial requirements:
 - a. Monthly Summary of Securities Lending Ledger, SBLF2a within fifteen (15) calendar days after the end of every six (6) months; and
 - b. Monthly Summary of Securities Borrowing Ledger, SBLF2b within fifteen (15) calendar days after the end of every six (6) months.
2. Any other SBL violations not covered by the above enumeration shall be considered minor violations.

The penalties imposed pursuant to these guidelines shall be without prejudice to any civil, criminal and/or administrative action that the Exchange may make against the violating trading participant in accordance with the circumstances.

a. Grave violations

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| 1. First violation | Written reprimand and fine in the amount of at least Php25,000.00 but not exceeding Php200,000.00 |
| 2. Second violation | Denial of (1) the exercise of the Trading Right and (2) access to the facilities and systems of the Exchange |
| 3. Third and subsequent violations | Restriction of the erring Trading Participant from entry to or employment in or any kind of commercial association with the Exchange or other Trading Participant. |

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b. Major violations

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| 1. First violation | Written reprimand |
| 2. Second violation | Fine of at least P10,000.00 but not more than P30,000.00 |
| 3. Third violation | Fine of at least P30,000.00 but not more than P50,000.00 |
| 4. Fourth and subsequent violations | Fine of at least P50,000.00. |

c. Minor violations


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| 1. First violation | Written warning |
| 2. Second violation | Written reprimand |
| 3. Third and subsequent violations | A fine of at least Php10,000.00 but not more than Php50,000.00 |



**PSE GUIDELINES ON
SECURITIES BORROWING & LENDING**

THE PHILIPPINE STOCK EXCHANGE, INC:

A handwritten signature in black ink, appearing to read 'Francisco Ed. Lim', written over a horizontal line.

FRANCISCO ED. LIM 
President and Chief Executive Officer

A handwritten signature in black ink, appearing to read 'Roel A. Refran', written over a horizontal line.

ROEL A. REFRAN *RR*
General Counsel

SECURITIES AND EXCHANGE COMMISSION

A handwritten signature in black ink, appearing to read 'Jose P. Aquino', written over a horizontal line.

JOSE P. AQUINO
Director, Market Regulation Department