



# **International Securities Lending Association (ISLA)**

## **Consultation Response 20.02.2020**

### **Securities Borrowing and Lending Regulations**

**Number (1-28-2017) Dated 16/6/1438H corresponding to 15/3/2017G**

### **Short Selling Regulations**

**Number (1-28-2017) Dated 16/6/1438H corresponding to 15/3/2017G**

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## About ISLA:

### Who are we?

The International Securities Lending Association (ISLA) is a leading industry association, representing the common interests of securities lending and financing market participants across Europe, Middle East and Africa. Its geographically diverse membership of over 160 firms includes institutional investors, asset managers, custodial banks, prime brokers and service providers.

### What do we do?

Working closely with the global industry as well as regulators and policy makers, ISLA advocates the importance of securities lending to the broader financial services industry. ISLA supports the development of a safe and efficient framework for the industry, by playing a pivotal role in promoting market best practices and processes, amongst other things. ISLA sponsors the Global Market Securities Lending Agreement (GMSLA) and the annual enforceability review in over 65 jurisdictions globally.

### How do we do it?

Through member working groups, industry guidance, consultations and first-class events, ISLA helps to steer the direction of the industry by developing Thought Leadership, standards for Legal Frameworks and Industry Guides & Best Practice documentation. ISLA is one of its most influential voices on the European and global stage.

Full details of our work and membership base can be found at:

<https://www.isla.co.uk/>

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## Introduction:

With reference to your recent announcement by The Saudi Stock Exchange (**Tadawul**) and The Securities Depository Center (**Edaa**) on updated regulations; Securities Borrowing and Lending & Short Selling, The International Securities Lending Association (**ISLA**) is delighted to have the opportunity to respond to this consultation.

Following the publication on 9<sup>th</sup> February 2020, we have been working with our industry stakeholders to review the amendment proposals outlined. The following comments and observations below, represent the consolidated views of ISLA and its member firms.

Whilst our response represents the combined views of the industry, please note that some of our members may have also submitted separate responses individually where appropriate.

For reference we have addressed our various observations in the order of which they are published:

## Securities Borrowing and Lending Regulation

### Part 1 Preliminary Provisions:

#### Article 1 Preliminary

**ISLA Response:** ISLA has no comment.

#### Article 2 Definitions, Section B

“ Expressions and terms in these Regulations have the meaning which they bear in the Capital Market Law and in the Glossary of Defined Terms Used in the Exchange Rules, unless the contrary intention appears.”

**ISLA Response:** ISLA ask that in addition to the definitions outlined within the Capital Market Law and the Glossary of Defined Terms Used in the Exchange Rules, can we ask that further definitions be provided for the following terms:

- Listed Security (To include subsection of Tadawul only listed securities)
- Legal Person & ‘person’
- Custody Member
- Broker (To include definitions for both onshore and offshore brokers – ISLA note that onshore brokers are one of the eligible SBL participants, and clarity around eligibility requirements to be an SBL eligible broker would be welcome. In addition, please clarify whether a broker as mentioned under Capital Markets Law, needs to be licensed to provide brokerage activities **or** is being a Qualified Financial Intermediary (**QFI**) sufficient?)
- Lender
- Lending Agent
- Borrowing Agent
- Client

ISLA ask that in providing these definitions – please also highlight where these definitions will be held and updated.

### Part 2 Securities Borrowing and Lending transaction

#### Article 3 SBL transactions, Section B, Point 4

“ the maximum duration of the SBL transaction is twelve months;”

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**ISLA Response:** ISLA note the proposed maximum duration of an SBL transaction is contemplated at 12 months; Could you please clarify how rolling overnight transactions and Evergreen trades would be treated? Does this rule apply to term trades only? If so, please provide further clarity on how these trades will be monitored and reported?

## Article 4 Eligible participants, Parts 1-4

“ Entering into an SBL transaction as borrowers and lenders is limited to:

- 1) legal person;
- 2) investment funds

3) clients of a person authorized by the Authority to conduct managing activities provided that:

- a. the Authorized Person has been appointed as an investment manager on terms which enable it to make a decision to enter into an SBL transaction on behalf of its client without obtaining prior approval from that client; and
- b. the decision to enter into an SBL transaction was made by the Authorized Person on behalf of its client.

4) natural persons allowed to open an investment account in the kingdom and an account at depository centre, and fulfil any of the following criteria:

- a. has conducted transactions in security markets of not less than 40 million Saudi Riyals in total, and not less than ten transactions in each quarter during the last twelve months.
- b. his net assets is not less than 5 million Saudi Riyals; c. works or has worked for at least three years in the financial sector;
- d. holds the general securities qualification certificate which is recognized by the authority;; or
- e. holds professional certificate that is related to securities business and accredited by an internationally recognized entity”

**ISLA Response:** Can you please confirm by way of specific additional language that offshore participants are eligible to participate in the local SBL market through either a custody member or broker or where the custody member is acting in an execution capacity? ISLA believe to attract international liquidity to this market, it is important to specify how international participants may participate in more detail. Absence to provide this clarity may lead to structural issues and could result in foreign investors not participating in the Saudi lending market.

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## Article 5 Eligible listed securities

“ An SBL transaction may only be entered into in respect of listed securities which the Depository Centre specifies, after notifying the Authority”

**ISLA Response:** ISLA would refer to our previous request for additional definitions in respect of eligible securities – Please see comments above in relation to Article 2.

## Article 6 Minimum collateral Section A

“ A borrower, or its agents if any , entering into an SBL transaction shall provide and maintain financial collateral as specified in the SBL agreement.”

**ISLA Response:** Can you confirm if it is possible for collateral securities to be settled offshore and if it is possible for collateral to be non-Saudi securities or cash? Is it allowable for SBL transactions to be settled Free of Payment (**FOP**) in the Saudi market?

## Article 7 SBL agreement Sections A-C

“ a. The parties of an SBL transaction must enter into a binding written SBL agreement which, as a minimum, contains terms which govern the matters specified in Annex 1 of these Regulations.

b. The Depository Centre may prohibit any potential party to an SBL transaction, from entering into an SBL transaction where in its view the terms of the SBL agreement do not meet the requirements set out in these Regulations.

c. The Depository Centre is not obligated to review the relevant SBL agreement or verify its contents”

**ISLA Response:** ISLA sponsors the Global Master Securities Lending Agreement (**GMSLA**) which is freely available to be used in all relevant markets and jurisdictions. We note that the contents of **Part 8 Annex**, are broadly covered by the terms and conditions of the GMSLA. We would therefore welcome a further conversation with the relevant stakeholders regarding the adoption of the GMSLA for the developing Saudi securities lending market. One of the most important factors embedded within the GMSLA, is the concept of offsetting liabilities and obligations in the event of default. ISLA supports enforceability opinions in over 65 jurisdictions globally and would be happy to work with local authorities and relevant stakeholders to ensure legal certainty across the developing market in Saudi.

As per our earlier comments, we would stress the importance of defining the relevant parties to the transaction which may include offshore participants only.

**For reference – Please see attached a copy of our current GMSLA, and guidance notes.**

It should be noted that the attached is the latest version of our Title Transfer Agreements.

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As an alternative to traditional Title Transfer Arrangements, ISLA has created a Pledge collateral version of the GMSLA. If you would be interested in our Pledge Collateral GMSLA, we can also make this available to you upon request. In this regard could you please confirm if you are contemplating both Title Transfer and Pledge Collateral business options within your market?

## **Article 8** Return of borrowed securities and collateral Section A-C

- ” a. A lender of borrowed securities shall accept every return of equivalent securities from the borrower, as specified by the depository Centre, and re-deliver collateral corresponding to such return to the borrower as agreed in the SBL agreement.
- b. Where there has been a failure to return borrowed securities in accordance with the terms of the SBL agreement, the custody member entered into an SBL transaction shall notify the depository Centre, and the depository centre will terminate the SBL transaction in accordance with the mechanism and the controls prescribed by the depository Centre from time to time.
- c. Where there has been a failure to return the collateral provided against borrowed securities in accordance with the terms of the SBL agreement, the custody member entered into SBL transaction shall notify the depository Centre, and the depository centre will terminate the SBL transaction in accordance with the mechanism and the controls prescribed by the Centre from time to time.”

**ISLA Response:** Our members have sought greater clarity around how this process will operate, in particular, can you provide further clarity on the following: **Section C**, Can you clarify the ‘mechanism and the controls prescribed by the Centre from time to time’? Under the current guidelines, does the market have in place an auto-buy mechanism? What are the buy in / fail costs? Do the same costs apply to Free of Payment (**FOP**) transactions related to the offshore lending and borrowing arrangements described above? With regards to the obligation on the Custody Member to notify the Depository Centre of failures to receive, can you please clarify how this communication will take place?

## **Part 3 Relending**

### **Article 9** Relending of securities Section A

” Securities which have been borrowed under an SBL transaction may only be lent once.”

**ISLA Response:** Can you please provide further clarification regarding the rule that securities may only be ‘lent once’. Our members have raised a number of important questions regarding the operation of this rule. Firstly, does this apply to onward lending within a borrower firm i.e. Intergroup lending of borrowed positions. How would onward lending rules be monitored and by whom? Is it contemplated that these rules would be monitored by the local market custodians? What provisions are contemplated regarding the re-registration of lent positions in the context

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of the books and records of the institutional investor who has lent the securities? Who will monitor and track these changes? Where a loan is returned by a borrower and the same security is relent by the lender, do the ‘relending’ rules apply or are they only applicable to a security that is onward lent to a third party?

## Part 4 Lending Agent and Borrowing Agent

### Article 10 Lending agent Section A

“ A person may enter into an SBL transaction as lending agent only if it is a custody member. or Broker.”

**ISLA Response:** ISLA would highlight previous comments and stress the importance of ensuring that offshore participants are expressly permitted to operate within this market via either a custody member, where the custody member would be acting in an execution capacity or broker. This would include the defined role of international securities lending agents and offshore brokers as requested in comments for Article 2.

### Article 11 Borrowing agent

**ISLA Response:** ISLA has no comment.

## Part 5 Powers of the Authority and the Depository Centre

### Article 12 Powers of the Authority and the Depository Centre Section A

“ a. The Authority, or the Depository Centre having obtained the approval of the Authority, may suspend or prohibit SBL transactions in respect of an eligible listed security, or may suspend or prohibit all SBL transactions in the Kingdom, at any time and as they deem fit, including but not limited to the following circumstances:

- 1) there are adverse events or developments which constitute a serious threat to financial stability or to market confidence;
- 2) for the protection of investors;
- 3) for the maintenance of an orderly market; or
- 4) trading in a listed security is suspended.”

**ISLA Response:** ISLA note that the language governing the powers of the depository centre are broadly unchanged however, during the review process a number of member firms have sought clarification regarding how an SBL transaction may be suspended at the depository centre rather than the security itself.

## Part 6 Reporting and Record Keeping Requirements

### Article 13 Copy of the SBL agreement

“ The Depository Centre may at any time require some or all custody members who entered into SBL transaction, to submit a copy of the SBL agreement with the relevant counterpart to the Depository Centre in accordance with the mechanism and the controls prescribed by the Depository Centre from time to time.”

**ISLA Response:** ISLA would highlight the need to ensure certainty and transparency around the respective parties to a transaction. We think it is important to allow for explicit recognition of onshore representatives for offshore lenders and borrowers. The implication, as written, is that the custody member has "entered into the SBL transaction" when ISLA would propose it be made clear that the custody member "executed" the SBL transaction on behalf of the offshore lender/borrower.

### Article 14 Reporting of SBL transactions

“ A custody member who has entered into an SBL transaction must report complete and accurate details of such transactions to the Depository Centre in accordance with the mechanism and the controls prescribed by the Depository Centre.”

**ISLA Response:** Where the SBL transactions are entered by the custody member (acting as execution agent on behalf of principal counterparties which are offshore lending clients and offshore borrowers), is the custody member able to record and report the SBL transactions? If so, how and by whom will these transactions be recorded and reported to reflect any onward movement of securities to offshore lender/borrowers?

### Article 15 Public disclosure of information

“ The Depository Centre may disclose any information with regard to SBL transactions as it deems fit.”

**ISLA Response:** Please clarify further details and potential frequency regarding the depth of information to be disclosed.

### Article 16 Record keeping Section B

“ A custody member must ensure records required to be maintained by these Regulations must be retained for a period of at least ten years from the date of the SBL transaction unless the Depository Centre specifies otherwise. In the event such records relate to any litigation or claim (including any potential litigation) or any on-going investigations, the custody member must ensure such records are retained until the conclusion of that litigation, claim or on-going investigation”

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**ISLA Response:** ISLA has no comment.

## Part 7 General Provisions

**Article 17** Limit of liability

**ISLA Response:** ISLA has no comment.

**Article 18** Waivers

**ISLA Response:** ISLA has no comment.

**Article 19** Publication and entry into force

**ISLA Response:** ISLA has no comment.

## Part 8 Annex

**Annex 1** Matters to be included in SBL Agreements, Point 1

**"Parties** - The names of all relevant parties of the SBL transaction including the lender, any lending agent, if any, the borrower, any borrowing agent (if any as applicable)."

**ISLA Response:** We would highlight that as agents represent many underlying clients, it is not typical to list each lender within the agreement. Details of lenders are exchanged electronically between lenders and borrowers. Forcing the inclusion of all party names within the agreement may be impractical and slow implementation. The GMSLA or equivalent agreement will name the lending agent and borrower, the Securities Lending Authorization Agreement (**SLAA**) will name the lender appointing the agent, and the lending agent will have a contract to appoint the custody member.

Lending agents and borrowers manage the inclusion of lenders in a relationship by means of the Agent Lender Disclosure mechanism which is well established internationally and achieves the same aim as listing in a contract. ISLA would recommend the adoption of this internationally acceptable standard for the management and disclosure of counterparties within lending programs.

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## Additional Comments

In addition, to the detailed points outlined in this consultation response, members firms have also enquired about the following:

- 1) **Tax** – Can you confirm that securities lending will be exempt from Capital gains, Stamp and VAT taxes?
- 2) **Disclosure** – Currently securities lending is classed as a disposal for disclosure reporting, is this still the case?

## Short Selling Regulation

ISLA have no additional feedback to the regulatory updates for The Short Selling Regulation other than the below, as our focus is primarily on the Securities Borrowing and Lending Regulation.

### Part 2 Short Selling Transactions

#### Article 3 – Short Selling Transactions Section B, Point 3 & Section C, Point 2

“ before the execution of the sale, the seller has borrowed the relevant security and the relevant security has been transferred to the seller's short selling account opened in accordance with the Depository Centre Rules; and”

**ISLA Response:** Would covering a short sale to reflect stock is on hold/has been located, be sufficient before the sell instruction was executed or would it be necessary to move the borrowed shares into a clients account before execution?

“ The following trades do not constitute short selling transactions for the purposes of paragraph (a) of this Article:

- 1) a sale of a listed security where the seller has entered into a corresponding purchase transaction in respect of those securities that settles on or before the settlement date of the sale; or
- 2) a securities borrowing and lending transaction in a listed security which is entered into in accordance with the SBL Regulations.”

**ISLA Response:** ISLA would stress that this should clarify that the sale of a security subject to a securities borrowing and lending transaction should be excluded and not the SBL transaction itself. Furthermore, ISLA would suggest to be included ‘where the seller holds the stock in inventory which has settled prior to the client order to short such a security has settled.’

#### Article 5 Eligible listed securities Section A, point 2

“Unless the Exchange specifies otherwise, a short selling transaction may only be entered into in respect of all listed securities in accordance with the following limits:

- 2) The total net short positions must not exceed 10% of the free floated securities of the relevant security”

**ISLA Response:** The Exchange report that is sent daily will act as T+1 Pre-Trade control - This is heavily manual and thereby prone to error. ISLA propose a long-term solution which focuses on an automated circuit breaker on the Exchange for any orders that will breach the outlined limit.