



**Pan Asian Securities Lending Association  
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Mr Jong Hyung Lee,  
Head of Securities Lending & Borrowing  
Korea Securities Depository,  
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19<sup>th</sup> April 2007

Dear Mr Lee,

It has come to the attention of the PASLA Executive Board that a number of our members have encountered issues with the KSD lending program in the past few months. These concern the treatment of certain corporate actions that have been declared on shares that are out on loan. You may be familiar with the below examples as our members have approached the KSD directly to discuss the problems they have encountered. The two issues that arose are as follows:

1. In a Tender offer on SEOUL SECURITIES (Sedol B0BXJ22), the lending client wanted to take cash and the borrowing Broker was directed to accept cash on the lender's behalf, which they did per international market practice. It later transpired that the KSD would not allow such a situation and stated that Article 27 of the KSD Regulations details entitlements deriving from loaned securities must apply – the Regulation doesn't mention a 'tender offer' specifically.

**Article 27 Entitlements Deriving from Loan Securities**

- (1) The Borrower shall deliver or pay to the Lender entitlements derived from the securities on loan such as cash dividend, stock dividend, interest, warrants, or new issues derived from the securities on loan(hereinafter “substitute payments, etc.”) in a manner prescribed in the Detailed Rules.
- (2) Notwithstanding Paragraph (1) herein, it is provided, however, that the preceding clause does not apply to the case where the Borrower of a Customized Transaction decides not to deliver or pay the substitute payments, etc. with the consent of the Lender in accordance with the Detailed Rules



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As translated by the KSD, in the event of a tender offer the exact securities you loan out must be returned in full (in the same shape and form) and a lender cannot take cash either in full or in part to close out the loan. Under a tender offer, all shareholders have the right to an equal opportunity to sell their securities. By restricting a lender only to receipt of the exact securities loaned out, the KSD is precluding the lender from exercising its corporate right entitlement. This does not facilitate equitable treatment of shareholders. In essence, lenders should have their entitlement protected in the same way as a buyer of a security over the ex/record date would expect protection against failing trades.

2. A borrow of 37,000 SNU PRECISION (Sedol B05GZ18), declared a stock dividend of 340 shares and bonus shares of 700. Market practice in all international markets is to increase the borrow by 1040 shares (either as one lot of 1040 shares or two lots of 340 and 700 shares), deliver the necessary collateral and pay the same fee as the original borrow, only returning stock when recalled or the borrow is no longer required.

The KSD stated that all stock dividends and bonus shares need to be returned to lender no later than 2 days after pay date. In exceptional circumstances you can extend this return date, but only by a few days, not in line with the original borrow.

The KSD stated that this was a KSD requirement, based on their procedures. Their systems were capable of booking the stock dividends and borrow increases, but the current procedures did not permit them to do this and it would be difficult for them to change. The KSD further stated that by not returning shares on pay date+2 the borrower is in default and the account may be suspended from trading SBL by the KSD.

PASLA would like to point out that both of the above two examples of dealing with corporate actions is outside of best practices employed in International Markets and with regard to Korea, these procedures differ from those outlined by the KSDA in its regulations. We are concerned that the foregoing would negatively impact both lenders and borrowers in the Korean market. Consequently, since the KSDA rules allow for such International Best Practices, this could drive lenders to insist that borrowers transact only through the KSDA methodology to protect their interests, a request that borrowers would have to comply with if they wish to deal with any lender making such a requirement.

There is a need for alignment between the governing SBL rules and the KSDA regulations which do allow for international best practice, to ensure corporate entitlements are preserved through direct holdings and SBL. The cornerstone of securities



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lending is for lenders to maintain ownership benefits and related entitlements on lent securities.

We feel that these are important issues that the KSD should address in their procedures to best serve its SBL users and also to remain competitive. PASLA would welcome the opportunity to discuss this further with you.

We look forward to hearing your thoughts on these issues.

Best regards,

A handwritten signature in black ink, appearing to read 'Sunil Daswani', is placed over a light blue rectangular background.

Sunil Daswani  
Chairman, PASLA