MEMORANDUM

June 5, 2012

To: File on Loan or Borrowing of Securities: Title IX Section 984(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")

Re: Meeting with Risk Management Association ("RMA")

On June 5, 2012, RMA members and staff as well as outside counsel met (some member representatives participated via teleconference) with Securities and Exchange Commission ("SEC") staff from the Division of Trading & Markets, the Division of Risk, Strategy and Financial Innovation and the Division of Investment Management. The purpose of the meeting was to discuss § 984(b) of the Dodd-Frank Act. The RMA provided copies of its recent "Statement of Best Practices for Disclosure and Transparency by Securities Lending Agents." A copy of that document is attached to this memo.

Attachment:
Statement of Best Practices for Disclosure and Transparency by Securities Lending Agents.

# RMA
## COMMITTEE ON SECURITIES LENDING

## STATEMENT ON BEST PRACTICES FOR DISCLOSURE AND TRANSPARENCY BY SECURITIES LENDING AGENTS

### 1. INTRODUCTION

The RMA Committee on Securities Lending promotes standards of best practice for securities lending agents ("Lending Agents"). This discussion paper furthers that goal by encouraging the communication of key information regarding securities lending transactions and agency securities lending programs by Lending Agents to their principal securities lending clients ("Principal Lenders") as well as to their borrower counterparties ("Borrowers"). The recommended disclosures to Principal Lenders are intended to provide Principal Lenders with a framework to better understand and evaluate the key considerations relating to engaging in, and monitoring their on-going participation in, an agency securities lending program in light of their own risk-reward profiles.

To provide context for the broader discussion, this paper first provides a brief overview of customary agency securities lending arrangements in the United States, including a description of the key parties and some of the main risks involved in such arrangements. After this brief introduction, the paper sets forth recommended practices for disclosure and transparency by Lending Agents in today's U.S. securities lending markets.

### 2. DESCRIPTION OF THE PRIMARY PARTIES IN AGENCY SECURITIES LENDING ARRANGEMENTS

As illustrated in the diagram below, customary agency securities lending arrangements involve three primary participants: (1) Principal Lenders, the beneficial owners of securities, engage (2) Lending Agents to lend their securities to (3) various principal Borrowers. In the event a Lending Agent does not provide custodial services, a separate custodial bank would be involved as the fourth primary participant. The Principal Lenders (often collectively referred to as the "supply side") are typically institutional investors, such as registered investment companies (including mutual funds and exchange traded funds), governmental and corporate pension funds, ERISA plans, endowment funds of non-profit institutions and insurance companies. Some types of Principal Lenders, such as mutual funds, pension funds or ERISA plans, have underlying beneficiaries or shareholders who hold an interest or units in the Principal Lender for investment or retirement benefit purposes but do not (and could not) actively participate in or direct investment decisions made by the Principal Lender.

In light of the array of operational and risk services needed to run a securities lending program, Principal Lenders commonly hire a Lending Agent to administer their program. Lending Agents consist of: 1) custodial banks that arrange the lending of securities on behalf of their custody clients; 2) investment managers that provide securities lending agency services as an adjunct to their advisory function; and 3) third party Lending Agents that provide securities lending agency services without having either a custodial or investment advisory relationship with its clients.[1] Some custodial banks and investment

[1] This discussion paper does not address the borrowing by broker-dealers of securities they hold in customer brokerage accounts (i.e. "fully paid lending") or the borrowing by broker-dealers of securities from other broker-dealers. Although such arrangements represent a significant portion of the securities lending market, the rules which apply and the nature of the relationships between the parties are significantly different from those for traditional agent securities lending as described herein. Further, this paper does not address proprietary securities lending programs designed to raise cash to engage in proprietary trading as those types of programs are quite different in design and purpose from the traditional agent securities lending programs described herein.

managers also provide lending services to Principal Lenders that are not otherwise their clients on a third party basis. Principal Lenders can retain a single Lending Agent or use a combination of Lending Agents, for different asset classes, markets, funds or for benchmarking purposes. Lending Agents have a contractual relationship with the Principal Lenders, but do not have any relationship, contractual or otherwise, with a Principal Lender's underlying beneficiaries or shareholders, nor could the Lending Agent normally identify such beneficiaries or shareholders.

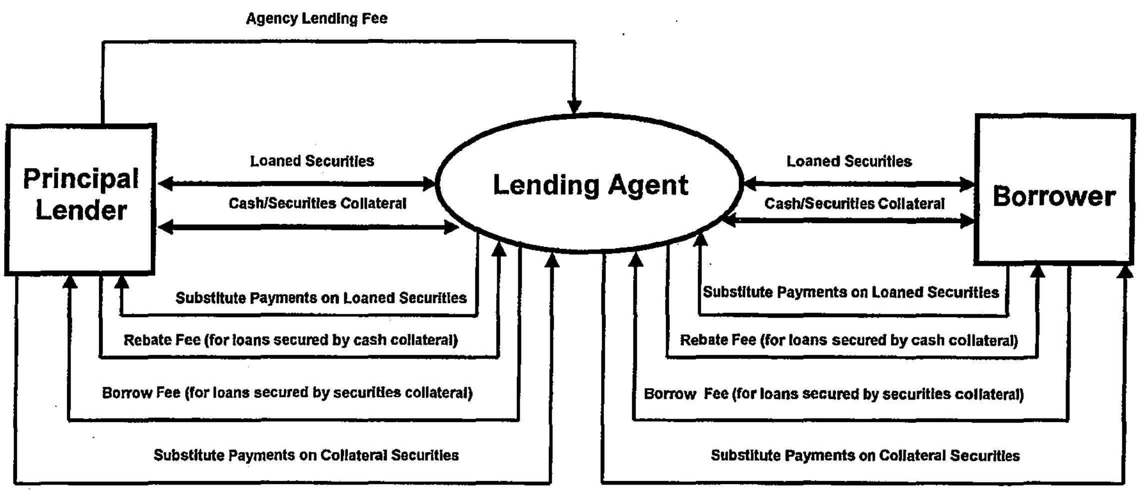
Borrowers in the United States are primarily brokers or dealers, but may also include banks or offshore entities. Borrowers may have underlying clients or relationships with end users, such as hedge funds, proprietary traders, market makers, arbitrageurs, specialists and other investors. For example, prime brokers, who provide a variety of services such as settlement, custody and financing services to their clients, borrow securities from Principal Lenders primarily for the purpose of making delivery in the case of short sales, fails to receive securities or similar circumstances and thus serve as intermediaries between the Agent Lenders and the investor end users. In such a case the prime broker is the Borrower and the Principal Lender's counterparty in the securities lending transaction, and neither the Principal Lender nor the Lending Agent has a relationship, contractual or otherwise, with the Borrower's clients, and thus does not know (and has no reason to know) the identity of the Borrower's clients.

Upon negotiation of a lending transaction with a Borrower, the Lending Agent instructs the Principal Lender's custodian to deliver securities to and receive collateral from the Borrower, in many cases on a "deliver versus payment" basis. If the collateral is cash, which is the predominant form of collateral for securities lending transactions in the U.S., the cash will be invested in a commingled investment fund (pool) or a separately managed account (SMA), consistent with guidelines approved by the Principal Lender. The cash collateral pool or SMA may be managed by the Lending Agent or an affiliate of the Lending Agent, by the Principal Lender itself, or by a third party. For securities loans that are collateralized with non-cash collateral, collateral may be delivered to a Principal Lender's account at a tri-party collateral agent (most common structure) or to the Principal Lender's custody account.

In addition to the primary participants noted above, there are also other service providers, such as consultants and market data service providers, who specialize in securities lending services. Consultants are sometimes hired by a Principal Lender to assist with the selection of a Lending Agent or the structuring of a lending program. Consultants may also seek to help the Principal Lender evaluate the performance of the Lending Agent and the program on a regular basis. Specialist market data service providers collect securities lending data from market participants (both Borrowers and Lending Agents) and offer access to the aggregated data for a fee.

The diagram below illustrates the key participants and flows involved in a typical agency securities lending arrangement.[2]

**Agency Securities Lending: Key Participants and Flows**




## 3. DISCLOSURE AND TRANSPARENCY BY LENDING AGENTS GENERALLY

The securities lending industry has evolved and matured since its inception in the 1970s (particularly in the last five to seven years), and the level and frequency of disclosures and transparency for securities lending participants, especially to Principal Lenders, has increased significantly. Securities lending has emerged from its origins in securities operations as an independent asset class often overseen by a Principal Lender's investment professionals. This, together with technological developments, have prompted more sophisticated and frequent disclosure and reporting comparable to that provided to participants in the short-term fixed income market.

In agency securities lending programs, disclosure can be achieved through a variety of communication channels and methods, including via verbal presentations, written presentation materials, responses to "requests for proposals" or RFPs, contractual provisions, formal disclosure documents, and on-going periodic reporting. This paper does not recommend any specific communication channel or method, but indicates when there is a common market practice to use a particular protocol to communicate specific types of information.

The Sections that follow describe the current recommended practices for disclosure and transparency by Lending Agents in today's securities lending markets. These practices give Principal Lenders significant transparency with respect to their securities lending programs, and enable them to create a framework to effectively structure, manage and assess their programs. Although we expect industry participants to continue to enhance their transparency, particularly as technology further evolves, we provide a description of the current recommended practices to help enable Principal Lenders to take an active role in tailoring their programs to their own risk-reward profiles.

[2] For ease of presentation, this diagram does not illustrate the involvement of other relevant parties, such as a third party manager of cash collateral pools or SMAs, a third party tri-party collateral agent, a custodial bank that is a separate entity from the Lending Agent, a clearing house, central counterparty, depository, or a consultant or other service provider. Further, for information regarding the Agency Lending Fee, see the description under the heading "Treatment of Securities Lending Revenues and Fees" in Section 4.c.

## 4. RECOMMENDED DISCLOSURE AND TRANSPARENCY BY LENDING AGENTS TO PRINCIPAL LENDERS

### a. Disclosure about the Basic Flows of Securities Lending Transactions, and the Structure of and Primary Parties in an Agency Securities Lending Program

Agent Lenders should describe to those Principal Lenders who have not previously engaged in securities lending activities or utilized a securities agency lending program, or who otherwise seem unfamiliar with securities lending, the basic flows of securities lending transactions, and the structure of and primary parties in an agency securities lending program.

### b. Risk Disclosure to Principal Lenders and their Acknowledgement of Risk

It is essential that Lending Agents disclose to Principal Lenders the risks related to securities lending conducted via an agency securities lending program, that Principal Lenders understand and accept such risks and that Principal Lenders understand how those risks may be addressed.

The major segments of risk associated with securities lending are:

(i) Counterparty and Credit risk;
(ii) Cash Reinvestment Risk;
(iii) Operational Risk; and
(iv) Legal, Tax and Regulatory Risk.

While the relationship between the Lending Agent and its Principal Lender clients typically promotes open communication regarding lending activities and issues, these risks should be clearly disclosed to the Principal Lenders. Commonly it is the terms of the contractual agreement between the Agent Lender and its Principal Lender client (the "Client Agreement") and the terms of the securities lending agreement with the Borrower (the "Loan Agreement") that together serve as the means by which the roles of the parties are described and the method by which these risks are addressed.

(i) Counterparty and Credit Risk

Counterparty and credit risk is the risk that the Borrower will not perform its contractual obligations to the Principal Lender. The Loan Agreement typically defines this risk by outlining the obligations of the Borrower. The main obligations of the Borrower are to provide collateral and meet collateral calls, to return loaned securities to the Principal Lender and to pay/transfer to the Principal Lender any distributions made on the loaned securities while the loan is open. If the Borrower fails to satisfy these obligations, the Loan Agreement typically outlines the available rights and remedies of the Principal Lender to address this risk. In addition to the remedies outlined in the Loan Agreement, the Client Agreement may specify or disclose additional methods to control counterparty and credit risk. These controls, which may be individually determined by each Principal Lender or which may apply generally to the Agent Lender's program, reflect a particular level of risk tolerance and specific concerns. To address counterparty and credit risk, the Client Agreement may include or disclose controls such as the process for the approval of Borrowers, Borrower concentration limits, collateral maintenance margins and limitations on types of acceptable collateral or the process for adjusting margins and the types of acceptable collateral. Lastly, many Lending Agents offer or arrange for indemnification against losses due to borrower default, pursuant to which the Principal Lender allocates some of the counterparty and credit risk to the indemnification provider while accepting this risk exposure against the indemnification provider (as more fully described in Section 4.c. below).

(ii) Cash Reinvestment Risk

As noted above, the Client Agreement will typically specify the party that is responsible for reinvesting the cash collateral, which may be the Lending Agent, the Principal Lender or a third party cash manager. As such, although reinvestment is a risk of lending securities versus cash collateral, it may or may not be part of the relationship between the Principal Lender and the Lending Agent. Cash reinvestment risk can be broken down into interest rate risk, liquidity risk, and credit risk. Interest rate risk is the risk that the cash collateral investments do not generate adequate interest to pay Borrowers the agreed upon rebate. Interest rate risk generally arises from a mismatch between the duration of the investments and the duration of the loans. A reinvestment portfolio should include processes and oversight for asset/liability management to mitigate interest rate risk. The key mitigants to interest rate risk are limiting the duration of loans and investments as well as limiting the gap between the duration of loans and investments.

Liquidity risk is the risk that the portfolio of investments purchased with the cash collateral does not have enough liquidity to fund flows for daily mark-to-markets, loan terminations due to Borrower returns or recalls by the Principal Lender, or in the event of a Borrower default. As mentioned above in reference to interest rate risk, duration limits and asset liability management are the most effective means to mitigate liquidity risk. The weighted average life of the loan book should be relative to the reinvestment portfolio based on the risk profile of the Principal Lender. Further, the guidelines for a cash collateral pool or SMA can specify that a certain amount or percentage of the total portfolio be invested on an overnight basis, so that cash is available the next day to meet any liquidity needs. A cash collateral pool or SMA may also adopt other strategies to generate more liquidity on a short term basis.

Credit risk refers to the loss of value of an investment either due to market price impairment during the life of a fully performing investment or nonperformance, including default. In most Client Agreements, the Principal Lender specifically acknowledges that it bears this risk and that the Lending Agent (or cash manager) is not responsible for any shortfall in principal value resulting from the investment of cash collateral. As cash collateral will be invested in either a commingled pool or SMA consistent with guidelines accepted by the Principal Lender, these guidelines act as a mechanism to control or mitigate credit risk. Specifically, in a SMA structure the Principal Lender can establish individualized cash reinvestment guidelines/parameters which may include restrictions on specific permissible investment types, minimum credit quality ratings on investment issuers, diversification limits on issuers and limits on maximum duration. In a pooled investment vehicle, such parameters are pre-determined and the Principal Lender selects the pooled investment vehicle which meets its requirements. In either case, Principal Lenders should be provided with reports indicating the details of each of the above parameters and a detailed listing of how such cash has been invested, as described in Section 4.d. If the Lending Agent is not involved in the management of the cash collateral, the Principal Lender should arrange to receive such reporting in a form and with a frequency sufficient for its needs.

In addition, some Lending Agents may offer or arrange for an indemnification in the event of a loss of principal on the investment of cash collateral. If provided, this indemnification is typically limited to covering certain counterparty risks in connection with reverse repurchase investments.

If non-cash collateral is accepted, there is no interest rate risk but there is still liquidity risk and credit risk in the event of a borrower default. In addition, there is an extra layer of operational risk due to the use, in most cases, of a tri-party custodian to receive, hold, and value the securities received as collateral and to take action quickly and accurately in the event of a borrower default. The Lending Agent should specify or disclose the selection and procedures used for interaction with a tri-party collateral custodian.

(iii) Operational Risk

One form of operational risk is recall risk, which is the risk that a Borrower is unable to return a security that has been recalled from loan by a Principal Lender in the standard settlement cycle for the security in the market it trades. The Principal Lender should be clearly informed of and accept its obligations with respect to the timing of sales notifications in order to mitigate against trade failures resulting from securities not being returned from loan by settlement date. The Client Agreement or the operational documentation for the Principal Lender's program is commonly the document that defines the settlement cycle and applicable notification requirements for each security type by market. All parties should be informed of the timing requirements and agree on a method of notification. The sales notification requirements in the Client Agreement or relevant operational documentation should match the settlement cycles typically outlined in the Loan Agreements and the risk of any mismatch should be disclosed.

Settlement risk is the risk that when executing a loan (transferring securities and accepting collateral) the Principal Lender is left with an unsecured or uncollateralized position. The Loan Agreement should specify that collateral should be received at the time of or prior to the delivery of loaned securities.

Other operational risks to be disclosed include risks associated with the mark-to-market process, such as improper or late valuation, the manufactured distribution process, the failure to timely receive notice or elect on corporate actions, and force majeure events such as natural disasters.

(iv) Legal, Tax and Regulatory Risks

This segment encompasses a fairly broad range of risks, including risks with regard to lending non-US securities. Examples or risks to be disclosed include the potential inability of the Principal Lender to take immediate action against collateral in the event of a default by the Borrower because of legal or regulatory reasons, the risk that certain unique economic rights may not be capable of being exactly manufactured by Borrower, and the potential loss of the current tax treatment for securities loans. In addition to disclosure of the risks, the Client Agreement will typically describe how these risks are controlled and who bears responsibility for any losses due to these risks.

### c. Recommended Disclosure Regarding the Rights and Responsibilities of the Lending Agent and the Principal Lender

As noted above, Lending Agents and Principal Lenders enter into Client Agreements. These Client Agreements establish a general agency relationship between the Lending Agent and the Principal Lender whereby the Lending Agent is authorized to lend securities on behalf of the Principal Lender. The Client Agreement may be a separate, free-standing agreement related solely to securities lending, or the authorization to lend securities may be included with other authorities in a trust agreement, a custodial agreement or an investment management agreement. However the Client Agreement is structured, it provides that the Principal Lender appoints and authorizes the Lending Agent to lend its securities and provides direction to the Lending Agent with respect to the parameters of the client's lending program and, if utilized, for the reinvestment of cash collateral. Client Agreements typically contain specific provisions with respect to the areas described directly below. Although this Section of the paper refers to disclosure commonly included in a Client Agreement, a Lending Agent could use a different means in which to provide the Principal Lender with disclosure regarding the Lending Agent's standard program which addresses each of the areas below (in which case the Client Agreement may not contain the same specific information).

Lendable Securities – The Client Agreement should provide for a process to identify securities that are available to loan and how that designation may be changed from time to time.

Administration of Securities Lending Program – The Client Agreement provides that the Lending Agent is authorized to act on behalf of the Principal Lender and may include a description of the lending process.

Approved Borrowers – Typically, the Lending Agent will make available to the Principal Lenders a list of Borrowers with which the Lending Agent may transact. There are at least two possible options for a Principal Lender to approve Principal Borrowers:

1. The Principal Lender may designate in the Client Agreement the Borrowers to which it chooses to lend (or elect to lend to any Borrower in the Lending Agent's program).
2. Alternatively, the Lending Agent discloses the Borrowers currently available for its lending program and the process used by the Lending Agent to add and delete Borrowers and to determine credit limits and the Principal Lender agrees to the disclosed process.

Specific disclosure should be included in Client Agreements if the Lending Agent or any of its affiliates are also Borrowers, and consent from the Principal Lender to lend to such Borrowers if required. Also, the

Client Agreement should specify a process whereby the Principal Lender can restrict or limit lending or otherwise change its choice of approved Borrowers.

Loan Agreements – The Client Agreement authorizes the Lending Agent to enter into Loan Agreements with Borrowers, typically in the form of an industry template such as the Master Securities Loan Agreement (2000) published by the Securities Industry and Financial Markets Association (or one of its predecessors) or a Lending Agent's equivalent bespoke agreement, on the Principal Lender's behalf.

Collateral – Principal Lenders should instruct the Lending Agent as to the forms of cash collateral (i.e., currency types) and non-cash collateral that the Principal Lenders will accept for its securities lending program. Initial margin levels, valuation and daily mark-to-market obligations should also be described in the Client Agreement. Alternatively, the Lending Agent may disclose the forms of collateral, the margins, and the mark-to-market process currently approved for its lending program, along with the process used to make changes to each of them, and the Principal Lender agrees to the disclosed arrangements.

Cash Collateral Reinvestment – If applicable, Principal Lenders will specify their desired reinvestment program, guidelines or strategy (which may include pooled investment structures, SMAs or the use of external or other cash managers) in the Client Agreement. The Client Agreement should also clearly disclose, and the Principal Lender should acknowledge, (i) that the Principal Lender bears the reinvestment risk (i.e., assumes the market or investment risk of loss on their cash collateral reinvestments) and (ii) if the Lending Agent (or an affiliate) serves as investment manager of the cash collateral, the advisory and other fees earned by the Lending Agent (or an affiliate) in connection with the reinvestment of cash collateral. Alternatively, the Lending Agent will disclose the cash collateral reinvestment strategy and cash collateral reinvestment funds used along with other relevant disclosures, and the Principal Lender agrees to the disclosed arrangement. If an external cash manager is used, then the roles and responsibilities of the parties should be specified.

Distributions on Loaned Securities – The Client Agreement should state that the Principal Lender is entitled to receive distributions (whether interest, dividends or other distributions) on the securities during the term of the loan, known as "substitute or manufactured payments." The Client Agreement may also specify the party responsible for the collection of those payments, which may not be the Lending Agent but a service provider working for the Principal Lender.

Voting Rights on Loaned Securities – The Client Agreement should disclose that the Principal Lenders will not be entitled to vote securities that are out on loan over the applicable record date.

Ability to Recall Securities on Loan – The Client Agreement should specify or disclose a process and timeline for recall of securities on loan. For example, a Principal Lender may recall securities that it has sold or to vote proxies.

Termination Provisions – The Client Agreement should contain termination provisions that outline the conditions or process for termination of the agency lending relationship by either party.

Treatment of Securities Lending Revenues and Fees – The Client Agreement should specify or disclose the negotiated fees to be paid by the Principal Lender to the Lending Agent for its services. Such fees are often in the form of a "fee split", typically expressed as a percentage, which dictates how loan earnings are to be divided between the Principal Lender and the Lending Agent. When loans are collateralized by cash, loan earnings are the net of the income from cash collateral reinvestments and the rebate paid to (or in the case of negative rebates, received from) the Borrower. When loans are collateralized by securities, loan earnings are equal to the negotiated loan fee paid by the Borrower. If the Lending Agent's fee is not paid pursuant to a fee split, the Client Agreement will specify or disclose how the fee is calculated.

Limitation of Liability and/or Allocation of Costs - The Client Agreement should provide or disclose who will be responsible for certain costs and/or fees associated with the Principal Lender's lending program (such as custodial charges and transaction costs) and specify any liability limitations applicable to the Lending Agent.

Client Reporting – The Client Agreement may also describe the types of reports (such as loan level and lending income reports) that will be provided to the Principal Lender. See Section 4.d. below for further discussion of transparency through reporting.

Borrower Default Indemnification – It is common for Lending Agents to provide Principal Lenders with Borrower default indemnification (or arrange for the provision of such an indemnification). This means that following a default by a Borrower, in the event that the collateral held from the Borrower is insufficient to pay for the repurchase of the securities that were lent to that Borrower (and not returned to the Principal Lender), after all claims have been settled, the Lending Agent or other party providing the indemnification will compensate the Principal Lender for the difference. The Client Agreement or a separate indemnification agreement should specify or disclose (i) events constituting a Borrower default and the party responsible for determining a default has occurred, (ii) the obligations of the Lending Agent or the Principal Lender relating to a Borrower default, (iii) which losses, expenses or costs are included in the Lending Agent's indemnification, and (iv) a description of the process to be used for determining the "loss" to be indemnified after a Borrower default.

SIPC Disclosure –The Principal Lender must acknowledge that the provisions of the Securities Investor Protection Act of 1970 may not protect the Principal Lender with respect to loans of securities. This disclosure is mandated by the U.S. Securities and Exchange Commission (SEC) if securities are being lent to SEC-registered broker-dealers. The point of the disclosure is to inform Principal Lenders that the collateral held (along with borrower default indemnification, if provided) is the main protection should a Borrower fail to return a borrowed security.

**d. Client Reporting: Disclosure and Transparency to Principal Lenders**

An important element of providing transparency to Principal Lender clients can be achieved through client reporting of such clients' securities lending activity. Detailed reporting that is available at frequent intervals is critical to the Principal Lender's ability to monitor its counterparty exposure, to determine whether the Lending Agent is operating within the Principal Lender's guidelines, to monitor and evaluate risks and performance, and to make changes to their lending guidelines and parameters as needed.

Following is a description of reports that may be made available by Lending Agents to their Principal Lender clients. Each Principal Lender may determine whether to receive any particular report, the frequency of any such report, and the format to be used. In some cases, a Principal Lender may decide to utilize a consultant or other third party to help it evaluate the information that is provided to it.

(i) *Borrower Counterparty Exposure.* All loans to a Borrower, including all asset types across all markets to reflect the total exposure to a Borrower, should be reported to a Principal Lender. This report may be at a legal counterparty or a parent counterparty level depending on the Principal Lender's needs or preferences.

(ii) *Loan-level Transparency.* Transaction details may include the following for each loan to a Borrower:

- Security name and identifier
- Number of shares or securities on loan
- Market price and collateralized price
- Collateral type
- Rebate rate (if cash) or fee (if non-cash)
- Yield on collateral investments (if available to the Lending Agent)
- Gross earnings
- Any fees, costs, or charges deducted from the gross earnings

- Net earnings to Principal Lender calculated in accordance with the terms of the Client Agreement

(iii) *Collateral Types and Collateralization Levels.* These may be reported on both per loan and per Principal Lender (i.e., per fund/account) bases. This may also include information about each piece of collateral if non-cash collateral is held, or each lending fund/account used if more than one.

(iv) *Rates.* The following information may be reported regarding rates, as applicable:
- Rebate per loan
- If non-cash, fee per loan
- Net earnings per loan

(v) *Collateral Reinvestments.* Information about the investment of cash collateral is typically provided by the cash manager. This function may be managed by an external third-party manager, the Principal Lender itself, or by the Lending Agent. If the Lending Agent manages the cash collateral pool or SMA in which a Principal Lender is invested, the details of cash reinvestment may include the following at the Principal Lender (i.e., fund/account) level or the collateral pool level:
- Instrument type
- Issuer
- Description
- Identifier
- Weighted Average Life (as measured to stated final maturity date or unconditional demand date)
- Weighted Average Maturity (as measured to interest rate reset)
- Credit ratings
- Yield
- Par value and amortized cost

(vi) *Benchmarking/Comparison to Market.* Some Lending Agents may provide benchmarking information to Principal Lenders, as discussed in more detail in Section 6 below.

## 5. RECOMMENDED DISCLOSURE AND TRANSPARENCY BY LENDING AGENTS TO BORROWERS

U.S. broker-dealers who borrow securities from Lending Agents acting on behalf of one or more Principal Lenders are required to obtain adequate information about the Principal Lenders to initially approve them as a counterparty, and to monitor their exposure on an ongoing basis. This information is shared among counterparts in common formats through a standardized information technology process agreed by the Agent Lender Disclosure Taskforce (the ALD Taskforce) in 2006. The ALD Taskforce consisted of representatives of Borrowers, Lending Agents and vendors that support securities lending market participants. The ALD Taskforce developed a uniform set of processes and procedures, and related infrastructure to facilitate disclosure of information sufficient to identify the Principal Lenders. This includes the Principal Lender's legal name, tax identification number (or another unique identifier for lenders who do not have a U.S. tax identification number), address, place of incorporation, and industry classification (common referred to as "entity type"). Financial data such as lendable assets and the net asset value of those assets which can assist broker-dealers in performing their credit risk reviews may also be provided in the Lending Agent's discretion.

In addition to the information required to pre-approve Principal Lenders, broker-dealers also have an obligation to monitor their credit exposure to each Principal Lender. The SEC has determined that SEC-registered broker-dealers that borrow through agency securities lending transactions generally should (i) maintain books and records of their loan activity with each Principal Lender, and (ii) monitor credit exposure to each Principal Lender, and calculate regulatory capital exposure with respect to each such lender. Consequently, Lending Agents provide broker-dealers with the details of each lending transaction on a daily basis, no later than the close of business on the next business day after the transaction settles.

Principal allocation information, which enables broker-dealers to determine which Principal Lenders are involved in each transaction, is provided for each Principal Lender in addition to the information with respect to lent securities and collateral described below.

Information provided to broker-dealers regarding lent securities includes a security identifier, such as the CUSIP, SEDOL or ISIN, and the amount of securities loaned. Collateral details should include the type of collateral (cash or non-cash) received on behalf of the Principal Lenders, the amount of cash (if any) received and the identifying information for non-cash collateral received. Standardized data file formats such as those developed by the ALD Taskforce should be used to convey the information regarding Principal Lenders, loaned securities and collateral.

The operational infrastructure and systems of Lending Agents and Borrowers reflect long-established, and in many cases standardized, processes related to securities lending, such as settlement, accounting, asset servicing, billing and reconciliation functions. The infrastructure and systems of these market participants enable them to share large volumes of detailed information on outstanding loans and enable each market participant to maintain an accurate, complete and current account of its lending book. An example of this is the contract comparison process, which entails the sharing of relevant data by Lending Agents and Borrowers relating to open contracts or contracts pending settlement at pre-agreed times. This can be done bi-laterally, but is more commonly done using a contract compare service provider. Through this process, Lending Agents and Borrowers are able to identify discrepancies in lending contracts on a daily or regular basis throughout the life cycle of a loan transaction, and to resolve differences as quickly as possible. This not only increases transparency, but also facilitates the mark-to-market and the billing process in connection with such transactions.

## 6. ANCILLARY MARKET INFORMATION

The disclosure and transparency to Principal Lenders and to Borrowers described in Sections 4 and 5 above relates solely to the particular transactions and relationships in which those Principal Lenders or Borrowers participate. This permits Principal Lenders and Borrowers to monitor their own lending activities with the respective Lending Agent. Additionally, many Lending Agents and Borrowers choose to provide detailed information regarding securities loan transactions to third-party data vendors that cleanse, aggregate, and make the data and resulting analyses available to them and other market participants for a fee. This information may be used to benchmark performance and evaluate the effectiveness of securities lending trading teams, trading strategies and other program aspects at an individual security level, asset class level, and portfolio/program level. Lending Agents may also choose to complement their reporting to their Principal Lender clients by furnishing this vendor data and analyses to them.