

Securities Lending in Physical Replication ETFs: A Review of Providers' Practices

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Executive Summary

In this updated report, we build upon our original examination of securities lending in physically-replicated exchange-traded funds (ETFs) in Europe, highlighting recent actions taken by providers in response to regulatory scrutiny and investor concern about counterparty risk.

We have conducted a survey of 10 European providers of physical replication ETFs. Our comprehensive study includes not only those providers that use physical replication for all or the majority of their ETF range, but also those that employ physical replication for a small number of their broader suite of ETFs.

Perhaps the most significant and welcome development we have seen in the last twelve months is enhanced transparency around providers' securities lending operations. Regulatory scrutiny and investor pressure have forced the largest European providers of physical ETFs to improve their disclosure standards.

These providers now post on their websites the composition and amount of collateral received against securities loans, the maximum and/or average on-loan levels, as well as the net return to the fund generated via securities lending. However, not all providers make this information readily available, limiting investors' ability to make more fully informed decisions.

We believe there is still room for improvement on the transparency front, especially with respect to the frequency and extent of the relevant information being disclosed. Disclosure of counterparties' identities remains subject to much resistance. However, this is about to change as ESMA's latest guidelines on ETFs and other UCITS require a list of borrowers to be published once a year in the funds' annual reports.

In response to clients' concerns about counterparty risk, a few providers have reviewed their lending programmes. As a result, some funds have stopped lending assets and others are now subject to limits on the amount of assets that they can lend out.

An increased number of issuers provide indemnification or some other type of protection against borrower default, and more are expected to do so in the near future.

Revenue sharing arrangements vary greatly across providers. At present, securities lending fees returned to funds range from 45% to 70% of gross revenues, with the ETF issuer and/or the lending agent retaining the balance, part or all of which is used to cover operational costs. Meanwhile, a couple of providers simply say they return 100% of the revenues, net of costs.

With the new ESMA guidelines, we believe there is no guarantee that more money will be returned to fund shareholders. Providers who consider they are currently charging reasonable costs for their services may not pass on more income to the fund. They may only change the way they disclose their arrangements going forward, stating that 100% of lending revenue is returned to the ETF, minus the fees paid to the fund manager and/or the lending agent, which may effectively be equivalent to the share of gross revenue they are retaining today. Thus, any changes to current practices made to comply with ESMA's new guidelines may be more a matter of semantics than economics.

Ultimately, our hope is that the additional transparency required by the regulator will serve to drive down the costs associated with securities lending by allowing competitive pricing pressure to come to bear. This, in turn, will hopefully lead to enhanced fund performance.

Foreword

The strong growth of the exchange-traded product (ETP) market has resulted in heavy scrutiny by international and local regulators over the last 18 months. Various potential risks have been highlighted in different types of ETPs, including physical replication ETFs.

Chief among the concerns raised by financial authorities about physical ETFs is their growing involvement in securities lending.

Although securities lending is not specific to ETFs and is in fact prevalent across the investment management industry taking place within mutual funds, pension funds and others to enhance returns, regulators have specifically called on ETF providers to enhance the level of transparency around their securities lending practices. They have also encouraged investors to gain a better understanding of the counterparty risk inherent to this activity.

In addition to regulatory scrutiny, there is no question that the heated physical/synthetic replication debate within Europe has played a major role in raising awareness about potential counterparty risk in physical replication ETFs. It is now widely accepted that securities lending in physical replication ETFs may create similar counterparty and collateral risks to the use of swaps in synthetic ETFs¹.

In July, the European Securities and Markets Authorities (ESMA) published its final consultation paper outlining its new guidelines for ETFs and other UCITS. The new guidelines, which are aimed at strengthening investor protection and harmonising regulatory practices across Europe, set forth new rules pertaining to securities lending within physical replication ETFs.

Against this backdrop, we have been conducting this review of current practices which updates and expands upon our first report on the matter published in September 2011.

In this updated report, we provide some additional context around the topic of securities lending, explaining what this activity is about, who is involved, its benefits and risks, as well as the safeguards put in place to protect investors from the inherent risks. We also highlight recent developments that we have seen leading up to ESMA's final guidelines and discuss the impact these developments and the new guidelines may have on current practices. We also reiterate what we believe to be industry best practices.

Additionally, we have produced comprehensive profiles of each of the providers of physical replication ETFs in Europe that engage in securities lending. Here, we closely examine the most crucial aspects of these providers' practices: borrowers/counterparty(ies), risk mitigation measures, fee sharing arrangements, disclosure levels, and the trailing 3-year lending activity by fund, showing annual average and maximum on-loan levels, as well as net returns.

Please note that the information we provide in these profiles was supplied to us directly by the relevant ETF providers. As such, we cannot guarantee that it is complete, accurate, or timely.

In sum, it is our hope that the work we present here will serve to further key stakeholders' understanding of securities lending in physical replication ETFs.

1. Note that synthetic replication ETFs can also engage in securities lending but it's typically done at the level of their parent bank, not at the fund level (as is the case for physical replication ETFs). This means that the bank, not the ETF, directly assumes the counterparty risk.

What is Securities Lending?

Securities lending is the process of temporarily loaning securities to a third party in exchange for a fee. Securities are normally lent on an open basis with no fixed maturity date², which gives lenders the flexibility to recall their securities at any time.

In the context of physically-replicated ETFs³, lending out a fund's holdings can help to partially, or in some cases completely, offset management fees and other sources of tracking error. As such, revenues generated from securities lending can be seen as a potential source of alpha.

While mutual funds, pension funds and insurance companies tend to be the biggest lenders of assets, ETFs and other passively-managed funds are also particularly popular among borrowers. This is because they have lower turnover than actively-managed funds and hence are less subject to the risk that the fund manager will recall the loaned securities.

A Well-Established, Yet Opaque, Practice

Securities lending is widely recognised as playing a vital function in today's global capital markets by improving market efficiency and liquidity. Yet, being as it is largely carried out over the counter, it remains a rather opaque activity and its true magnitude is difficult to assess. A number of data companies estimate the amount of securities on loan worldwide to be between \$1.5 trillion and \$3 trillion. According to Markit, there are currently \$132 billion worth of equities on loan in Europe.

The lack of transparency within investment funds around securities lending makes it equally difficult to quantify the benefits of such practices for end investors. Conservative estimates from ISLA⁴ suggest that European investors

earned €1 billion in securities lending revenues during 2011. Based on our own survey data, we can say that around €40 million in net revenue was generated from this activity in European physical replication ETFs last year with the balance of assets on loan approximating €9.2 billion.

Who's Borrowing and Why?

Securities lending is rarely undertaken directly between a fund and a borrower. Fund managers usually employ intermediaries, such as custodian banks and third party specialists, as agents to lend their securities for them. These intermediaries benefit from economies of scale, expertise, technology, as well as borrower access which enables them to secure the most competitive pricing. In some cases, the lending agent may be a related party to the fund provider.

Borrowers of securities include large financial institutions, such as investment banks, market makers and broker-dealers. Hedge funds are among the largest borrowers of securities, but they will typically borrow through the prime brokerage arms of investment banks, or broker-dealers, rather than directly from lending agents or fund managers.

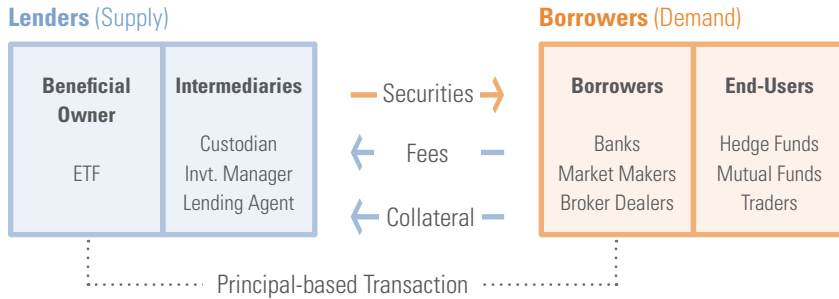
These financial institutions borrow securities for a variety of reasons, including ensuring the settlement of trades, as well as to facilitate market making and other trading activities, such as hedging and short selling.

2. In its final guidelines on ETFs and other UCITS, ESMA requires that a fund be able at any time to recall any security that has been lent out or terminate any securities lending agreement into which it has entered.

3. The lending of ETF units is a growing area of the market but it is beyond the scope of this paper.

4. ISLA is the International Securities Lending Association.

The Who's Who of Securities Lending



Source: Morningstar, ISLA

Often associated with hedge funds seeking profit from falling stock prices, short selling has attracted a lot of controversy and bad press since the financial crisis. Regulators around the world have periodically introduced bans on this practice under the belief that short sellers were responsible for pummeling the share prices of certain equities, especially banks. Many academic studies have since concluded that short-selling bans did little to stop the slide in equity prices and in fact resulted in decreased liquidity,

impaired price discovery and wider bid-ask spreads.

Also, according to industry data specialist Data Explorers⁵, it is actually rare for lending demand to be driven by fundamental short-selling, i.e. a simple speculative bet that the value of a security will fall, with the borrower hoping to buy it back more cheaply to close out their position at a later date. More commonly, short positions are taken as part of an arbitrage strategy, such as convertible bond arbitrage, merger arbitrage, etc.

Another arbitrage strategy that doesn't involve short selling is dividend tax arbitrage, also known as tax optimisation. This is a widespread activity affecting European equity ETFs which can make a significant contribution to the funds' returns, especially during dividend season. During these periods ETF providers lend stocks that are subject to dividend withholding tax to counterparties located in more tax-efficient jurisdictions. In this way, physical replication ETFs can avoid a portion of the withholding taxes levied on dividends by European countries.

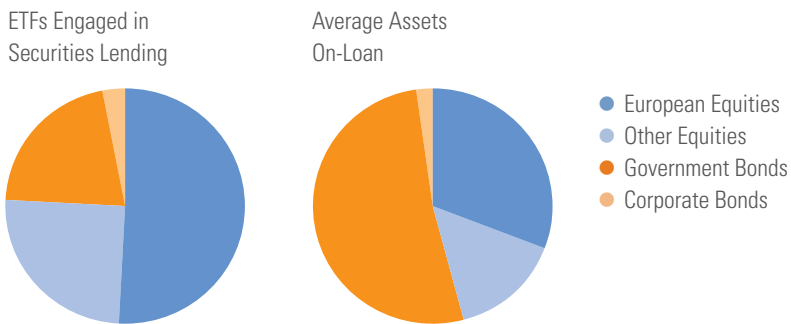
5. <http://www.dataexplorers.com/sites/default/files/Making%20Better%20Informed%20Securities%20Lending%20Decisions.pdf>

How Much of Your ETF is Out on Loan?

Our survey reveals that around 45% of physical replication ETFs in Europe were engaged in securities lending in 2011.

As indicated in the charts below, about three quarters of these funds were equity ETFs and one quarter were fixed income ETFs. In terms of actual loan activity, equities accounted for 46% of loaned securities while bonds represented about 54% of assets on loan. The great majority of loaned fixed income securities were government bonds, the demand of which was mainly driven by financing needs and collateral requirements.

Lending Activity by Asset Class as of 2011



Source: Morningstar.

Considerations Before Loaning a Fund's Securities

Prior to enrolling a security in a funds' lending programme, a lender must assess a number of factors, notably regulatory, legal, tax and liquidity restrictions. These considerations will determine the amount of "lendable" securities in a fund, i.e. the amount of securities that a fund can make available for lending.

While some physical replication ETFs will have a highly lendable asset base, others will offer less potential for lending. Funds that track the MSCI Emerging Markets Index are a good case in point. Currently, a large part of the index's market capitalisation is not lendable because securities lending is not permitted in China, India and Russia, while Brazil is just opening up to the practice. Meanwhile, lending markets for South Korean, Taiwanese and Turkish securities have become more active in recent years.

Another factor that will typically be considered before engaging the securities of a fund in a lending programme is the level of fees that these assets can earn. Lending fees can vary greatly from security to security and are a function of supply and demand. Generally, hard-to-borrow, small, and illiquid securities command higher fees than widely available, large and heavily-traded securities. For instance, alternative energy and property stocks have attracted some of the highest fees in recent years, while German government bonds have yielded very low returns to lenders.

Lending fees will also depend on considerations unique to each transaction, including the nature, size and duration of the transaction, the type of collateral offered and the credit quality of the counterparty involved in the transaction.

On-Loan Levels Vary Significantly

The amount of assets that can be lent out varies considerably from provider to provider and from fund to fund. Some providers who have easy access to securities lending programmes are happy to lend as many assets as possible, irrespective of the revenue that can be generated. Others will only authorise lending from ETFs when the return is meaningful in absolute or relative terms. These different approaches result in on-loan levels ranging from 0 to 100%.

Unlike in the U.S. where a fund is not permitted to lend more than 50% of its total assets,⁶ there is currently no regulated maximum on-loan level in Europe.⁷ ETF provid-

ers on this side of the Atlantic have the right to lend out up to 100% of their funds' assets, and a few indeed do so.

For instance, both ETFlab and iShares lent up to 100% of the assets held by their German government bond ETFs last year. So did ComStage with its Dax and Euro Stoxx 50 ETFs. Also, about 25% of the physical replication ETFs we surveyed⁸ had more than half of their assets on loan at some point in 2011.

However, effective average utilisation rates tend to be much lower. Last year, 85% of ETFs lent less than half their assets on average and around two thirds lent less than 20%.

2011 Maximum On-Loan Levels

Max On-Loan	Number of ETFs	% of ETFs
< 30%	102	55
30% < X < 50%	36	20
> 50%	46	25
Total	184	100

2011 Average On-Loan Levels

Avg. On-Loan	Number of ETFs	% of ETFs
X < 10%	88	48
10% < X < 20%	32	17
20% < X < 30%	24	13
30% < X < 40%	6	3
40% < X < 50%	7	4
50% < X < 60%	7	4
60% < X < 70%	11	6
70% < X < 80%	2	1
80% < X < 90%	2	1
90% < X < 100%	5	3
Total	184	100

Source: Morningstar

Meanwhile, some other providers, namely Source, Think Capital, db X-trackers, Julius Baer and Ossiam have chosen not to get their physical replication ETFs involved in securities lending, either for ease of management or to limit the associated risks. XACT, which has been involved in securities lending in the past, has suspended its programme and is currently reviewing its practices. Finally, Vanguard, the latest entrant in the European ETF space, plans to engage its ETFs in the lending programme that it has already in place for its index funds as soon as sufficient assets are raised.

Finally, it's important to understand that the level of securities lending activity within a physical replication ETF may vary over time and this will affect the fund's risk-return profile.

An example of this is European equity ETFs that engage in tax arbitrage during dividend season—around April and May. With a higher proportion of the fund's assets on loan over this period, the fund's embedded risk will increase. The trade-off would be one of enhanced performance as the extra income gets incorporated into the fund's NAV.

Any increase in lending activity will result in an additional revenue stream which can either reduce a fund's negative tracking difference relative to its index, or even, in some cases, turn a negative tracking difference into a positive one, in which case the fund will outperform its index.

Recent Developments

Against the backdrop of heavy regulatory scrutiny and investor concern about counterparty risk, the last twelve months have been marked by some interesting changes to a few providers' lending programmes.

Specifically, ETFlab removed all of its six German government bonds ETFs from its programme last December. This move was attributed to the perceived safe-haven status of the funds' holdings. Specifically, it was decided that there would be little sense in lending out these funds'

assets and accepting what many would perceive to be relatively less safe assets as collateral against these loans.

More recently, BlackRock, State Street and HSBC decided to limit the amount of assets that all their ETFs can lend out to third party borrowers. Lending levels have been capped at 50%, 70% and 20% for iShares, SPDR and HSBC ETFs, respectively. In practice, these self-imposed thresholds will affect only a small minority of these providers' funds, if any, in the instances of SPDR and HSBC.

It's nonetheless worth noting that these decisions were made while the contentious question of whether or not

to impose a limit on the amount of assets a fund could lend was still being debated within the European Securities and Markets Authority (ESMA). In its final guidelines, the regulator stopped short of recommending any limits for the proportion of assets that may be subject to securities lending.

6. CETFA : In the U.S., ETFs generally may not lend more than one-third of total assets. In calculating this limit, the SEC's staff has taken the view that the collateral (i.e., the cash or securities required to be returned to the borrower) may be included as part of the lending fund's total assets. Thus, an ETF could lend up to 50% of its asset value before the securities loan.

7. There are restrictions in France, where funds that are eligible for the PEA (Equity Savings Plan) can't lend out more than 25% of their assets, as a result of regulation requiring that these funds invest at least 75% of their portfolio in European equities.

8. Calculation based on 2011 data provided to us. Seven Swiss-domiciled UBS ETFs are not included.

Counterparty Risk in Securities Lending

As with all investment activity, securities lending carries risks. The main risk is that the borrower becomes insolvent and is unable to return the loaned securities.

To assess this counterparty risk, the first question that needs to be asked is: who are the counterparties?

Who Are the Counterparties?

The answer mainly depends on the type of lending programme the fund is engaged in. There are two basic types currently used by European ETF providers: the agency-based programme and the principal-based programme. While the majority of issuers employ only one type of arrangement--mostly the agency model--a few issuers have both arrangements in place depending on the jurisdiction in which their funds are domiciled.

It is important to understand the difference between these two models because they will have different and important implications as to the fund's ultimate counterparty. In an agency lending programme, the fund has multiple third party borrowers as counterparties. In a principal lending programme, the entire counterparty risk lies with a single borrower, i.e. the bank acting as principal, regardless of whether it subsequently on-lends to third parties.

Once the counterparties have been identified, the subsequent question that investors need to address is: What safeguards are put in place to mitigate counterparty risk?

Counterparty Risk Mitigation Measures

To mitigate the counterparty risk inherent to securities lending, borrowers are required to post collateral for the duration of the loan in order to secure their obligation to return the borrowed securities. This collateral⁹ typically takes the form of securities or cash, and is equal to at least 100% of the value of the lent securities to account for the risk of subsequent fluctuations in the value of the assets on either side of the loan.

In the European ETF market, liquid OECD equities and G7-G10 government bonds seem to be the most commonly accepted form of collateral, to which additional margins/ haircuts ranging from 0% to 15% are currently applied depending on the type and quality of the securities received. Corporate bonds are another type of eligible collateral, albeit taken by only a few providers. Cash and certificates of deposit can also be accepted, although these forms of collateral are less widely-used in Europe than in the US.

It is important to note that collateral parameters are usually defined by the fund manager, even when the securities lending activity is conducted through a lending agent. Collateral is normally held in a segregated custodial account in the name of the fund and is not re-used.

Collateral Quality is Key

Collateral quality and margins/haircuts are crucial factors when assessing risks in securities lending. There is always a chance, in the event a borrower defaults, that the collateral won't be sufficient to repurchase the lent securities. If this occurs, ETF shareholders would suffer a loss equal to the difference between the value of the collateral and the replacement cost of the lent securities.

This risk, referred to as collateral risk, can be mitigated by taking high quality, highly liquid securities and applying appropriate margins/haircuts to ensure maximum liquida-

tion value for ETF shareholders in the event a borrower defaults. Following the new ESMA guidelines, funds that lend more than 30% of their assets will have to be subject to regular stress tests in order to assess the liquidity risk attached to the collateral.

In addition, collateral should be sufficiently diversified in terms of country, markets and issuers, according to ESMA's new guidelines. It must also be marked-to-market on at least a daily basis to ensure that adequate levels of collateralisation are maintained at all times and increased in times of heightened volatility.

Finally, ESMA doesn't require a high level of correlation between the collateral provided and the securities on loan.

Reinvestment Risk

Investors should be aware that cash collateral may give rise to reinvestment risk. Specifically, this is the risk that the securities in which the cash collateral is subsequently invested incur losses or otherwise underperform relative to other investment options or relative to rebates¹⁰ paid. Reinvestment risk is not much of an issue in Europe where cash is rarely taken as collateral. In the very few instances where it is, the cash collateral is not reinvested.¹¹

In the U.S., where cash collateral represents approximately 80% of the collateral received in securities lending programmes, a certain number of lenders faced major liquidity issues during the financial crisis of 2008/09 when their cash collateral was reinvested in what they thought were highly liquid cash instruments, like auction rate securities, which became extremely illiquid in the face of the credit crunch.

9. Most securities lending occurs under industry-standard master agreements. Securities lending agreements used outside the US involve transfer of legal title, with the lender becoming legal owner of the collateral. See Securities Lending and Repos: Market Overview and Financial Stability Issues, FSB Report - 27 April 2012. According to ESMA's guidelines, collateral received should be capable of being fully enforced by the fund at any time. Non-cash collateral received should not be sold, re-invested or pledged.

10. When stocks are loaned against cash collateral, rather than the borrower paying a fee, it receives a rebate, which is the interest rate payable on the cash received net of the implied lending fee. Typically, the lender reinvests the cash at an interest rate higher than the rebate rate, and the difference is their income.

11. ESMA's final guidelines contain an exhaustive list of assets in which ETFs and other UCITS may decide to reinvest the cash collateral received.

Careful Selection of Borrowers

A diversified and careful selection of borrowers through constant monitoring of their creditworthiness is central to minimising the risk associated with securities lending. The regular review of counterparty credit risk is especially important in the case of deterioration of the counterparty's financial situation or the specific situation of the market.

It is usually the manager of the ETF that sets its own list of eligible counterparties, even when a lending agent is used.

Borrower Default Indemnification

Another important measure that ETF providers can take to mitigate the risk faced by funds involved in securities lending is indemnification. This is equivalent to an insurance policy aimed at protecting fund shareholders against the default of a borrower.

Currently, the majority of ETF issuers provide some kind of indemnification, with BlackRock being the latest one to offer such a provision for all its European-domiciled iShares ETFs. And we expect more to follow suit in the near future.

While we believe that the proliferation of additional protections is good for ETF investors, they need to understand exactly who is providing the protection and assess the financial strength of that entity, be it the lending agent, the asset manager or the bank. In the event of a borrower default, concomitant with a collateral shortfall, the ETF

would ultimately be exposed to the robustness of the balance sheet of the entity offering the protection.

Additionally, investors should be aware that there are different types of indemnities. Lending agents can offer full replacement indemnification, whereby they promise they will replace all the unreturned securities regardless of cost (using the proceeds from the liquidation of the collateral). Meanwhile, others may provide the cash value necessary to repurchase the securities, with the fund having to potentially bear the cost of repurchasing the unreturned securities. Also, lending agents generally don't cover losses incurred on the reinvestment of cash collateral.

Finally, as with all insurance policies, the extent of the coverage of the indemnification, and in fact of any kind of default protection offered, may vary. It is therefore important to understand exactly what risks and under which circumstances the fund will be protected.

Revenue Sharing Arrangements

The degree to which revenues generated via securities lending augment the performance of a fund is an important consideration. Obviously, the absolute amount of securities a fund lends out and the rents charged on these securities loans are the most important drivers of gross securities lending revenues. But the degree to which these revenues are split between the fund provider and/or the lending agent, and fund shareholders is also vital to understand.

Our survey reveals that revenue sharing arrangements vary greatly across providers. And so does the way they are disclosed to investors, which can make comparisons difficult. At present,¹² the majority of providers disclose fee splits as a percentage of gross revenues. Based on this calculation, we found that the portion of revenues returned to the fund could range from 45% to 70% of gross revenue, with the ETF issuer and/or the lending agent retaining the balance, part or all of which is used to cover the operational costs relating to the activity.

Meanwhile, a few providers say they return 100% of the associated revenues, net of costs. They don't, however, currently disclose the amount of these costs.

These disparities, which clearly show that some issuers are more generous than others, were noted in our previous report. We were, and still are, of the opinion that if the fund (and thereby its investors) is ultimately assuming 100% of the risk associated with the lending of its assets, then it should be compensated in proportion and receive 100% of the revenue (net of costs).

We are pleased to see that ESMA shares our opinion. In its final guidelines on ETFs and other UCITS issues, the regulator noted that all revenues arising from securities lending, net of direct and indirect operational costs should be returned to the fund. Also, ETF providers are required to

disclose all fees and costs associated with this activity, and the identity of the parties to which such fees and expenses are paid.

That said we are cognisant that, as it is formulated, this new rule is subject to interpretation and debate. Specifically, it all comes down to how one defines "costs". Costs can be incurred at various stages of the securities lending process allowing each participant to charge a fee for their services.

Perhaps the most easily quantifiable costs are the fees retained by lending agents. Their fees cover a number of functions including, but not limited to, arranging lending transactions, monitoring the quality of borrowers, managing collateral, and in some cases, providing indemnification. Based on our survey, we can say that the level of fees currently charged by lending agents to European physical replication ETFs vary from 10% to 40% of gross revenues, depending on the extent of the services offered. The percentage may also depend on the size and the securities lending revenue-generating potential of the funds included in the programmes. By way of comparison, ISLA¹³ notes that 30% of gross revenues is a figure representative of the average amount typically charged by lending agents.

In addition to the cost associated with the lending agent, the fund's investment manager may seek compensation for carrying out oversight functions which include selecting and monitoring counterparties and setting collateral parameters, among other activities associated with facilitating the lending service.

A Matter of Semantics?

All in all, we think that the new ESMA requirement is positive for investors in physical replication ETFs, and other UCITS, as it will likely prompt fund providers to review their fee sharing arrangements and re-evaluate whether the fees they are currently charging are reasonable and justified.

12. This survey was conducted before ESMA published its final guidelines ETFs and other UCITS issues on 25th July.

13. http://www.isla.co.uk/images/PDF/Publications/sl_intro_guide.pdf

However, there is no guarantee that more money will be returned to fund shareholders. While the new rule may force some providers, especially those who are keeping an unjustified share of the securities lending revenue for themselves, to pass on more revenue to the fund, others may not do so because they consider that they are currently charging a reasonable amount for the services that they and/or their lending agent are offering. These providers will only change the way they disclose their fee sharing arrangements going forward, stating that 100% of the lending income is returned to the ETF, minus the costs and fees paid to the fund manager and/or the lending agent, which will effectively be equivalent to the share of gross

revenue they are retaining today. Thus, any associated changes to current practices may be more a matter of semantics than economics.

Ultimately, whether or not providers choose to rethink their lending fee structures in order to return more income to investors, our hope is that the additional transparency required by the regulator will serve to drive down these fees and costs by shedding some light on them and allowing competitive pricing pressure to come to bear. This, in turn, will hopefully lead to enhanced fund performance.

Enhancing Transparency

Ultimately, the key question for investors is whether the incremental return earned from securities lending is sufficient to justify the risks associated with this practice. To be able to assess this risk/reward trade-off, investors need access to a range of information which should be made readily available to them by ETF issuers.

There has been progress made over the past year with regards to disclosure standards. Four issuers of physical ETFs, namely iShares, Credit Suisse, UBS and State Street, are now disclosing details of their lending programmes on their websites. This compares to only one (iShares) a year ago. On a fund-by-fund basis, the information provided usually includes average and maximum on-loan levels, collateral composition, collateralisation level, and net return. The frequency of updates can vary depending on the provider and the nature of the information. But they are typically done on a daily, monthly or quarterly basis.

We certainly welcome this increased level of transparency which we called for many times in the past. It is comforting to note that the bulk of our recommended best practices have been adopted by some of the largest providers of physical ETFs in Europe, and we encourage those falling short of the mark to follow suit.

We are also pleased to see the beginning of an alignment of disclosure standards between physically-replicated ETFs and synthetic replication ETFs as it pertains to counterparty risk. However, the former still have some way to go relative to the latter. Issuers continue to be quite selective about the information they choose to make publicly available about their physical replication ETFs. This lack of uniformity is in stark contrast with the more consistent level of disclosure that has been achieved in synthetic replication ETFs over the last 18 months.

It goes without saying that transparency is to the benefit of all stakeholders, not only investors but also sponsors. Through full and regular disclosure, sponsors can show that they are working in the best interest of their clients and that they value their clients' right to know about the risk/reward trade-off associated with securities lending activity. In our view, this is crucial to maintain trust. This, in turn, will allow fund providers to attract more assets under management.

Recommended Best Practices

While we are pleased to see the progress that has been made on the transparency front, we think there is still room for improvement beyond ESMA's requirements as it pertains to the frequency and extent of the relevant information being disclosed.

We think that providers of physical replication ETFs should post on their websites the following information for each fund:

- ▶ The average amount of securities on loan (in % of AuM) over the trailing one month period. This information, alongside the revenue generated, is currently shared by some providers with their clients on a monthly basis. We would therefore suggest that disclosing monthly average on-loan levels is best practice. Though some providers may argue that this number remains stable throughout the year, and as such warrants less frequent (quarterly) disclosure.
- ▶ The maximum amount of securities on loan over the last 12 months (in % of AuM). As previously discussed, a number of providers have imposed a maximum on-loan limit for their ETF range. Yet, effective maximum levels may vary greatly from fund to fund. So looking back at the last 12 months can give investors a good indication of the actual securities lending activity of a particular fund.
- ▶ The amount and composition of collateral received. While many investors might not be able to make sense of the make-up of the collateral, its daily disclosure will certainly help build the trust of clients and allow for greater scrutiny of the assets used in securities lending programmes. This, in turn, will ensure that this collateral is consistently comprised of high-quality, liquid assets, which, in the event of a borrower's default, would be easy to liquidate in order to repurchase the lent securities.

▶ The net revenues arising from securities lending activities (in basis points) on a monthly or quarterly basis, together with all the associated costs/fees and the name of the beneficiaries of these fees. Again, this will help investors to know if they are being adequately compensated for the additional risk they are assuming. It will also ensure that investors are aware of potential conflicts of interest and how they may impact the performance of the fund. The most prevalent potential conflict of interest arises when entities from the same group act as the ETF provider and as the lending agent.

The provider's risk management policy should be clearly explained on the website. It should include details on:

- ▶ Collateral policy with the accepted types of collateral, level of margins/hairecuts required and, in the case of cash collateral, the firm's re-investment policy.
- ▶ Indemnification or other types of additional protection offered by the securities lending service providers to protect fund shareholders from a borrower's default.

Additional disclosure relates to borrowers' identities. Particularly sensitive, the frequent disclosure of who is on the other side of the lending transaction remains subject to much resistance. The argument goes that any changes in a borrower's activity could be wrongly interpreted by the market, and ultimately move prices. For instance, the reduced participation of a borrower in a provider's lending programme could be mistaken as a credit signal.

Although we will stop short of making a judgement on the validity of this argument, we think that providing an updated list of all counterparties on a quarterly basis could prove useful. And this is purely under the understanding that this list remains very stable. Again, such level of disclosure would give investors assurance that the quality of credit standards set by the ETF issuers is always maintained. In its new guidelines, ESMA requires the identities of the borrowers to be published only once a year in the fund's annual report.

Summary of Securities Lending Practices in Physical Replication ETFs

	Total Physical ETFs ¹	Phys ETFs Engaged in Sec Lending ²	Current Set on Loan Limit % ³	2011 Effective Max on Loan% ⁴	2011 Revenue Returned to the Fund	Counterparties	Eligible Collateral (Margins)	Borrower Default Indemnification
Amundi	3	3	*22	*22	60% of gross	3rd parties	Equities (110%), bonds (107%), cash (105%)	no
ComStage	2	2	100	100	100% net of costs	Commerzbank	Bonds (100%-104%)	n/a**
Credit Suisse	49	9	95	n/d	60% of gross for Swiss/Lux ETFs 50% of gross for Irish ETFs	Credit Suisse for Swiss/Lux ETFs 3rd parties for Irish ETFs	Equities & bonds (102%-115%)	n/a** no***
EasyETF	10	9	*25 100	*25 n/d	45% of gross	3rd parties	Equities (110%), gov. & corp. bonds (102%-115%) cert of deposit & cash (105%)	no
ETFlab	38	38	100	100	100% net of costs	DekaBank, CBF, 3rd parties	Equities & bonds (103%-110%)	no***
HSBC	25	12	20	n/d	60% of gross	3rd parties	Gov. bonds (105%)	yes
iShares	184	78	50	100	60% of gross	3rd parties	Equities (110%-112%), gov. bonds (102.5%-108%) cert of deposit & cash (103.5%-108%)	yes
PowerShares	16	1	33	n/d	70% of gross	3rd parties	Cash, US gov. bonds & US gov. backed repos (100%)	yes
SPDR ETFs	41	12	70	58	60% of gross	3rd parties	Equities & gov. bonds (102%-105%)	yes
UBS	44	27	100	82	Variable	3rd parties for Lux/Irish ETFs UBS for Swiss ETFs	Gov. bonds (101%-105%), equities (102%-115%)	yes n/a**

1. As of 30/06/2012

2. 2011 data

3. Current maximum percentage of assets that can be lent out. Lending 100% of a fund's assets is permitted by European regulation, but a few providers have recently set internal limits

4. Maximum percentage of assets on any single day in 2011 that was effectively on loan

* Regulatory maximum of 25% applies to French PEA-eligible ETFs

** ETF providers lending on a principal basis can't provide indemnity against their own default

*** CS & ETFlab ETFs have other types of protection in place.

Provider Profiles

Please note that the information we provide in these profiles was supplied to us directly by the relevant providers. As such, we cannot guarantee that it is complete, accurate, or timely.

Amundi

Amundi, jointly-owned by Crédit Agricole (75%) and Société Générale (25%), offers three physical replication ETFs, all of which have been involved in securities lending since 2003.

The Amundi CAC 40 ETF is domiciled in France while the Amundi S&P Europe 350 and S&P Euro ETFs are domiciled in Ireland.

Counterparties

The Amundi securities lending process is a bi-party set-up that involves no lending agent. A list of 30 counterparties selected by Amundi's Risk Committee is reviewed quarterly after an annual due diligence process.

Current counterparties include: Bank of America, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, Groupe BPCE, Groupe Crédit Mutuel, HSBC, ING, JP Morgan, Lloyds, Morgan Stanley, Newedge, Nomura International, Rabobank, Royal Bank of Canada, Royal Bank of Scotland, Société Générale, Standard Chartered, UBS, Exane.

Risk Mitigation

Acceptable collateral include equities, bonds and cash. Amundi takes equities from well-known large cap indices. Accepted bonds include G5, G7, G10 bonds and minimum AA-rated corporate bonds.

The following haircuts are applied: 10% for equities, 5% for cash and 7% for bonds.

The marked-to-market collateral is held in a segregated account in the name of the ETF. The collateral received cannot be re-used.

Revenue Sharing Arrangement

The revenue sharing arrangement between the Amundi CAC 40 ETF and the ETF provider is stated in the fund prospectus in compliance with AMF regulation. Securities lending revenues are split 60/40, with the fund receiving 60% of the revenues, the provider 40%. The provider covers all operational costs.

For the two Irish funds, 70% of the revenues are passed on to the funds and 30% to the fund manager.

Disclosure

Currently, information about securities lending in Amundi ETFs is disclosed upon request but it will be soon made available on the provider's website.

Securities Lending Activity by Fund

Amundi's physical ETFs are eligible for the PEA (the French Equity Savings Plan) and as such must invest a minimum of 75% of their assets in European equities. As a result, the amount of lendable securities can't exceed 25% of the fund's NAV. Amundi has set a 22% cap and this internal rule has been applied for the last 3 years.

Amundi 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM **Mil Eur
Amundi ETF CAC 40	19.1	21.8	6.5	25	702
Amundi ETF S&P Europe 350	n/d	*22.0	n/d	35	104
Amundi ETF S&P Euro	n/d	*22.0	n/d	35	26

Source: Amundi ETF. Data to end December. * Maximum on-loan level set by Amundi. ** AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

ComStage

ComStage offers two physical replication ETFs and both have been involved in securities lending since their inception in July 2010.

ComStage ETF FR DAX and ComStage ETF FR EURO STOXX 50 are domiciled in Luxembourg.

Counterparties

ComStage lends the funds' assets to its parent company, Commerzbank AG. Although the bank may on-lend the assets to third parties, Counterparty risk lies directly with Commerzbank AG.

Risk Mitigation

ComStage currently takes bonds as collateral, to which additional margins of 0% to 4% are applied depending on the bonds' maturity. ComStage does not accept any

securities which are affiliated with Commerzbank.

Revenue Sharing Arrangement

The funds receive 100% of the income generated through securities lending, net of costs. These costs haven't been disclosed.

Disclosure

Information including revenue earned from securities lending and maximum on-loan level is disclosed in the funds' annual reports.

ComStage also provides details about its risk management process and collateral upon request to institutional investors.

Securities Lending Activity by Fund

ComStage can lend out up to 100% of the funds' securities.

ComStage 2010/2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM *Mil Eur
ComStage ETF FR DAX	n/d	100	11	15	31
ComStage ETF FR EURO STOXX 50	n/d	100	11	15	12

Source: ComStage. Data to end June 2011. * AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

CS ETFs

Credit Suisse Asset Management (CS AM) started to engage its physical replication ETFs in securities lending over ten years ago. Currently 15 (6 funds were added to the programme in March 2012) out of a total of 49 physical replication ETFs engage in this practice.

CS ETFs are domiciled either in Switzerland, Luxembourg or Ireland.

Counterparties

Depending on the ETF's domicile, CS AM has a different process in place.

All the Swiss- and Luxembourg- domiciled ETFs lend securities to Credit Suisse AG on a principal basis, meaning Credit Suisse AG is the only eligible borrower, or counterparty. The bank then on-lends the securities to third parties.

For the Irish-domiciled ETFs, Bank of New York Mellon (BNY Mellon) acts as securities lending agent, contracting directly with market counterparties. The risk management teams at Credit Suisse and BNY Mellon work together to define the set of eligible counterparties. Credit Suisse retains the right to veto the use of a counterparty.

Risk Mitigation

Collateral is managed by the securities lending service providers and specific collateral requirements vary by jurisdiction.

In general, CS ETFs accept only high quality debt securities and large-cap equities from developed markets. Depending upon the jurisdiction, these could be AA or A rated bonds or equities from major indices such as the S&P 500, FTSE 100, Nikkei 225, etc.

Margins vary between 2% and 15% depending on the asset being lent and the asset being taken as collateral which is held in the name of the fund at the custodian.

The custodian for Swiss and Luxembourg-domiciled ETFs is Credit Suisse. Collateral cannot be re-hypothecated.

For Irish-domiciled ETFs, custodian and lending agent BNY Mellon provides protection against losses that may occur from a collateral shortfall in a counterparty default. This additional default protection is relative to a standard securities lending programme.

Revenue Sharing Arrangement

Revenue sharing arrangements vary across jurisdictions. Irish-domiciled ETFs receive 60% of the gross lending income while Swiss- and Luxembourg-domiciled ETFs receive 50% of the gross lending income. All transaction

costs are borne by the securities lending service provider, namely Credit Suisse or Bank of New York Mellon.

Disclosure

Credit Suisse provides daily disclosure of the collateral held against securities lending activity in all its ETFs. This is available through the CS ETF website for the prior business day's activity. Additionally, at least semi-annually, CS provides a summary of securities lending performance (e.g. return to the fund and average on-loan). This document is available online too.

Securities Lending Activity by Fund

The regulatory maximum on-loan level in all three jurisdictions is 100%. However, CS AM sets an internal limit of 95% for its ETFs. CS does not maintain historical statistics of maximum on-loan levels.

The average utilisation rate throughout the year varies across funds and jurisdictions.

Credit Suisse only authorises lending from ETFs when there is a sufficient return to be made, measured in absolute or relative terms.

The following funds were added to the CS lending programme on 01/03/2012: CS ETF (IE) on EURO STOXX 50, CS ETF (IE) on MSCI EMU, CS ETF (IE) on MSCI EMU Small Cap, CS ETF (IE) in MSCI Europe, CS ETF (IE) on MSCI Canada, CS ETF (IE) on MSCI Japan.

CS ETFs 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM **Mil Eur
CS ETF (CH) on SMI	3.0	n/d	0.3	39	2654
CS ETF (CH) on SMIM	8.4	n/d	3.6	49	762
CS ETF (CH) SLI	2.9	n/d	0.5	39	386
CS ETF (CH) on SBI Domestic Gov. 1-3*	0.4	n/d	—	20	215
CS ETF (CH) on SBI Domestic Gov. 3-7	2.6	n/d	0.2	19	496
CS ETF (CH) on SBI Domestic Gov. 7-15*	0.1	n/d	—	25	65
CS ETF (Lux) on MSCI EMU Large Cap	20.9	n/d	36.0	49	255
CS ETF (Lux) on MSCI EMU Mid Cap	24.0	n/d	28.8	52	109
CS ETF (Lux) on MSCI Emerging Markets	2.1	n/d	1.8	68	1069

Source: CS ETF. Data to end December. * No longer included in the CS ETF lending programme. ** AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

EasyETF

EasyETF started to engage its physical replication ETFs in securities lending in 2005. Currently, 9 out of a total of 10 physical ETFs are involved in this practice.

EasyETF funds are domiciled in either France or in Luxembourg.

Counterparties

BNP Paribas Securities Services (BP2S) acts as lending agent for the EasyETF physical replication range.

Securities are lent to numerous counterparties active in the market, in compliance with portfolios' guidelines and credit risk criteria set by BNP Paribas. The list of counterparties is approved by BNP Paribas Investment Partners' (BNPP IP) risk department, and monitored and reviewed on an ongoing basis.

Risk Mitigation

For the French-domiciled ETFs, lending transactions are collateralised with cash (for a maximum of 15% of the fund's NAV) at 105% of the loan amount, and eligible securities. Cash collateral is not reinvested.

For Luxembourg funds, only securities are accepted as collateral.

Eligible securities include OECD equities (110%), government bonds (102%-110%), corporate bonds (including convertible bonds) (110%-115%), money market instruments, certificates of deposit (eligible OECD and other eligible countries, min. rating A) (105%), and supranational bonds (min. rating AAA) (102%). Collateral is marked-to market and adjusted on a daily basis.

Collateral is held in a segregated account at the fund's custodian, BP2S, and can't be lent out.

Revenue Sharing Arrangement

45% of the gross securities lending revenues are paid to the funds, while EasyETF and the lending agent retain 45% and 10% respectively. All operational costs are covered by the lending agent.

Disclosure

EasyETF discloses the following information upon request: maximum and average on-loan levels, revenues generated from securities lending and paid to the fund, revenue sharing scheme, and type of collateral with haircuts.

Securities Lending Activity by Fund

The ETFs that are eligible for the PEA (the French Equity Savings Plan) can't lend out more than 25% of their assets, as a result of regulation requiring that these funds invest at least 75% of their portfolios in European equities.

EasyETF 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM *Mil Eur
EasyETF CAC 40	20-25	25	1.0	25	458
EasyETF Euro Stoxx 50	20-25	25	4.1	25	412
EasyETF FTSE EPRA Eurozone**	20-25	25	0.2	45	257
EasyETF FTSE EPRA Europe**	20-25	25	0.1	45	146
EasyETF NMX30 Infrastructure Global**	n/d	n/d	0.7	50	48
EasyETF Low Carbon 100 Europe	20-25	25	2.7	60	55
EasyETF Iboxx Liquid Sovereigns Extra Short	90	n/d	3.6	15	15
EasyETF Iboxx Liquid Sovereigns Global	85	n/d	3.5	15	204
EasyETF Iboxx Liquid Sovereigns Long	85	n/d	3.5	15	13

Source: EasyETF. Data to end December. * AuM as of 30/06/2012. Source: Morningstar Direct. ** EasyETF FTSE EPRA Eurozone: net return over 2 months only, EasyETF FTSE EPRA Europe: net return over 3 months, EasyETF NMX30 Infrastructure Global: net return over 5 months only. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

ETFlab

ETFlab's physical replication funds started to engage in securities lending in March 2008. Currently, 32 out of a total of 38 physical replication ETFs are involved in this practice. Six funds were removed from the programme in December 2011.

All ETFlab funds are domiciled in Germany.

Counterparties

ETFlab can lend up to 10% of a fund's assets to parent bank DekaBank on a principal basis, meaning DekaBank is the only eligible counterparty to the ETFs. The bank may then on-lend the securities to third parties.

Additionally, ETFlab can lend up to 100% of a fund's assets to Clearstream Banking Frankfurt (CBF), which is an organised lending system.

ETFlab funds may also lend securities directly to third parties subject to a limit of 10% of fund assets per counterparty. The ETFlab EURO STOXX 50 is currently the only fund that uses this mechanism for dividend tax optimisation purposes. In all cases, DekaBank is the securities lending service provider.

Risk Mitigation

ETFlab accepts equities and bonds as collateral from DekaBank, and European Central Bank (ECB) - eligible baskets from Clearstream Banking Frankfurt. CBF has direct access to the ECB accounts of all the borrowers. In the event of a borrower default, if the collateral and the ECB account don't cover the whole claim, a guarantee of a banking consortium will cover the shortfall.

All fixed income securities received as collateral must be eligible collateral for the ECB. Additionally, there is a

concentration limit that restricts the weight of each bond to a maximum of 10% of the value of the fixed income portfolio.

Eligible equities must be listed on a main European stock exchange. No stock is permitted to represent more than 3% of the value of the collateral portfolio.

Margins applied to the collateral received are: 3% for DekaBank, 5% for Clearstream and 10% for third party borrowers. All collateral is held in segregated accounts in the name of the ETF.

Revenue Sharing Arrangement

The fund receives 100% of the revenue generated through securities lending, net of costs. These costs haven't been disclosed.

Disclosure

ETFlab discloses on-loan levels, lent securities, counterparties and collateral composition upon request. Securities on loan and collateralisation levels are disclosed in annual reports.

Securities Lending Activity by Fund

ETFlab withdrew its six Deutsche Boerse EUROGOV Germany ETFs from its securities lending programme in December 2011. This move was attributed to the perceived safe-haven status of the funds' holdings. Specifically, it was decided that there would be little sense in lending out these funds' assets and accepting what many would perceive to be relatively less safe assets as collateral against these loans.

ETF/Flab 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM ***Mil Eur
ETFlab DAX®*	31	59	6.7	15	639
ETFlab DAX® (ausschüttend)*	5	19	1.1	15	203
ETFlab EURO STOXX 50®*	18	49	18.7	15	459
ETFlab STOXX Europe 50®*	10	31	2.3	19	6
ETFlab MSCI Europe*	8	44	2.5	30	24
ETFlab MSCI Europe LC*	9	47	2.2	30	33
ETFlab MSCI Europe MC*	20	37	7.9	30	5
ETFlab MSCI USA*	7	15	1.7	30	33
ETFlab MSCI USA LC*	23	50	6.1	30	48
ETFlab MSCI USA MC*	35	78	9.6	30	2
ETFlab MSCI Japan*	13	17	3.4	50	7
ETFlab MSCI Japan LC*	32	35	8.1	50	7
ETFlab MSCI Japan MC*	34	42	8.8	50	1
ETFlab MSCI China*	19	45	7.4	65	14
ETFlab EURO STOXX® Select Dividend 30*	11	21	5.5	30	33
ETFlab STOXX® Europe Strong Growth 20*	17	44	19.0	65	2
ETFlab STOXX® Europe Strong Value 20*	19	36	9.4	65	3
ETFlab STOXX® Europe Strong Style Composite 40*	42	61	22.3	65	3
ETFlab DAXplus® Maximum Dividend**	15	33	9.5	30	84
ETFlab iBoxx € Liquid Sovereign Diversified 1-10**	50	63	4.3	15	9
ETFlab iBoxx € Liquid Sovereign Diversified 1-3**	54	71	4.5	15	42
ETFlab iBoxx € Liquid Sovereign Diversified 3-5**	54	66	4.6	15	7
ETFlab iBoxx € Liquid Sovereign Diversified 5-7**	62	86	5.0	15	12
ETFlab iBoxx € Liquid Sovereign Diversified 7-10**	75	90	6.4	15	8
ETFlab iBoxx € Liquid Sovereign Diversified 10+**	45	59	3.8	15	9
ETFlab Deutsche Börse EUROGOV® Germany**	69	100	6.1	15	513
ETFlab Deutsche Börse EUROGOV® Germany 1-3**	68	99	6.0	15	291
ETFlab Deutsche Börse EUROGOV® Germany 3-5**	70	100	6.1	15	392
ETFlab Deutsche Börse EUROGOV® Germany 5-10**	70	100	6.1	15	313
ETFlab Deutsche Börse EUROGOV® Germany 10+**	61	97	5.4	15	27
ETFlab Deutsche Börse EUROGOV® Germany Money Market**	69	100	6.0	12	150
ETFlab Deutsche Börse EUROGOV® France**	59	95	4.8	15	9
ETFlab Deutsche Börse EUROGOV® France 1-3**	64	89	5.4	15	7
ETFlab Deutsche Börse EUROGOV® France 3-5**	64	98	5.3	15	15
ETFlab Deutsche Börse EUROGOV® France 5-10**	76	98	6.3	15	10
ETFlab iBoxx € Liquid Germany Covered Diversified**	38	47	3.4	9	130
ETFlab iBoxx € Liquid Corporates Diversified**	27	39	2.3	20	99
ETFlab iBoxx € Liquid Non-Financials Diversified**	22	33	1.9	20	239

Source: ETFlab. * Data to end January 2012. ** Data at end of February 2012 *** AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

HSBC ETFs

HSBC ETFs plc started to engage its European range of physical replication ETFs in securities lending in 2010. Currently, 12 out of its 25 funds are actively participating in this practice.

All those funds are physically replicated and domiciled in Ireland.

Counterparties

HSBC Securities Services (HSS), a division of HSBC Bank Plc, acts as lending agent for HSBC ETFs plc.

HSS lends the funds' assets to a very diverse range of clients globally, including HSBC Bank Plc, fund managers, Sovereign Wealth Funds, insurance companies and pension funds.

Risk Mitigation

Eligible collateral is determined by the directors of HSBC ETFs plc, in accordance with UCITS requirements. However, a more restrictive collateral policy is employed by HSBC ETFs plc, and is limited to debt obligations issued or guaranteed by the government or a government department or agency of the governments of Austria, Belgium, Canada, Denmark, Finland, France, Germany, Japan, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom or the United States of America.

All securities on loan are over-collateralised by at least 5%. The 5% minimum haircut is increased when war-

ranted by market conditions and/or counterparty concerns.

The lending agent provides a default indemnity for all external borrowers, offering to replace any securities that an external borrower would fail to return. All market exposure is therefore at the risk of HSBC and underpinned by its balance sheet.

To ensure safety of the assets in the event that HSBC itself defaults, all HSS agency lending collateral accounts are segregated from the bank's own assets, in accordance with regulatory requirements. Collateral can't be lent out.

Revenue Sharing Arrangement

Currently, all HSBC ETFs receive 60% of securities lending gross revenue, while 40% is retained by the lending agent and the investment manager. The agent covers all lending related costs.

Disclosure

HSBC is currently working on a monthly securities lending factsheet, which will include information such as 12-month return, average and current on-loan level, and collateralisation level for each fund. That information is currently only available upon request.

Securities Lending Activity by Fund

In March 2012, HSBC introduced a 20% limit on the amount of assets that a fund can lend out. This limit applies to all HSBC ETFs.

HSBC ETFs 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM *Mil Eur
HSBC MSCI EM FAR EAST ETF	0.0	n/d	0.1	60	16
HSBC MSCI CHINA ETF	0.3	n/d	2.0	60	26
HSBC MSCI JAPAN ETF	0.5	n/d	0.9	40	37
HSBC MSCI PACIFIC ex JAPAN ETF	1.5	n/d	0.4	40	92
HSBC EURO STOXX 50 ETF	9.0	n/d	61.6	15	42
HSBC FTSE 100 ETF	0.7	n/d	2.5	35	316
HSBC FTSE 250 ETF	0.1	n/d	0.4	35	36
HSBC MSCI EUROPE ETF	3.8	n/d	21.2	30	31
HSBC MSCI TURKEY ETF	2.6	n/d	3.2	60	4
HSBC MSCI CANADA ETF	3.2	n/d	3.0	35	13
HSBC MSCI EMERGING MARKETS ETF	0.1	n/d	0.6	60	232
HSBC MSCI WORLD ETF	0.8	n/d	6.1	35	74

Source: HSBC ETFs. Data to end March 2012.** AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

iShares

BlackRock included the European-domiciled iShares ETFs in its securities lending programme in 2003. Currently, 78 out of a total of 184 iShares physical replication ETFs participate in the programme.

The European iShares physical replication ETFs are domiciled either in Ireland or in Germany.

Counterparties

BlackRock acts as the lending agent for the iShares funds. The list of borrowers that received securities loans over Q1 2012 include Bank of America, HSBC, Bank of Nova Scotia, JP Morgan, Barclays, Morgan Stanley, Citigroup, Goldman Sachs Group, Credit Suisse, The Royal Bank of Scotland Group, Deutsche Bank, Santander, and UniCredit.

When assessing whether or not to initiate a trading relationship with a new counterparty, BlackRock focuses primarily on credit and reputation risk.

Risk Mitigation

The approved list of securities which can be used as collateral includes liquid equities from major benchmarks, and government bonds from the UK, USA, Germany,

France, Belgium, Netherlands, Switzerland, Canada, Sweden, Austria and Japan. The additional collateral requirement (margin) varies from 10-12% for equities to 2.5-8% for government bonds.

BlackRock may also take certificates of deposit with margins of 3.5-8%. For operational reasons, cash collateral (in USD, EUR, or GBP) might be accepted, however not for reinvestment purposes. Margins of 3.5-8% are applied.

Collateral is marked-to-market on a daily basis and can't be lent out.

BlackRock provides borrower default indemnification, i.e. it commits to replace the securities that a borrower would fail to return. The indemnification arrangement is subject to changes, and in some cases without notice.

Revenue Sharing Arrangement

60% of all securities lending revenue is paid directly into the funds, with BlackRock covering all operational costs—including the cost of the indemnity—out of its 40% share.

Disclosure

On its website, iShares discloses its fee sharing arrange-

ment, collateral parameters, daily collateral holdings, counterparty selection policy, list of active counterparties over the trailing 12-month period (released quarterly, with one month lag), average and maximum percentages of the fund on loan as well as net returns to the fund over the trailing 12-month period (released quarterly, with one month lag).

Securities Lending Activity by Fund

Prior to May 2012, BlackRock could lend out up to 100% of its iShares funds' assets. However in May, the company decided to cap lending for each fund at 50% in response to client's concerns about counterparty risk.

The company's German-domiciled funds were only added to the combined BlackRock Securities Lending platform towards the end of 2010.

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Replication ETFs: A Review of Providers' Practices**

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iShares Irish ETFs 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM *Mil Eur
iShares AEX	10	36	21.7	30	210
iShares Barclays Cap Euro Government Bond 15-30	40	54	4.4	20	45
iShares Barclays Cap Euro Inflation Linked Bond	45	67	5.3	25	514
iShares Barclays Capital Euro Government Bond 1-3	24	31	2.6	20	642
iShares Barclays Capital Euro Government Bond 3-5	47	57	5.1	20	384
iShares Barclays Capital Euro Government Bond 7-10	66	95	7.4	20	297
iShares EURO STOXX 50	7	39	16.2	35	3,337
iShares EURO STOXX 50 (Acc)	4	39	17.2	35	35
iShares EURO STOXX Mid	11	26	21.4	40	112
iShares EURO STOXX Select Dividend 30	14	29	17.6	40	309
iShares EURO STOXX Small	14	35	19.1	40	217
iShares EURO STOXX Total Market Growth Large	9	41	19.0	40	40
iShares EURO STOXX Total Market Value Large	9	43	14.3	40	31
iShares FTSE 100	2	16	1.6	40	4,090
iShares FTSE 250	92	95	15.0	40	536
iShares FTSE BRIC 50	7	11	5.5	74	677
iShares FTSE China 25	19	28	7.4	74	676
iShares FTSE EPRA/NAREIT Asia Property Yield Fund	9	15	3.1	59	159
iShares FTSE EPRA/NAREIT Developed Mkts Property	0	0	0.0	59	1,310
iShares FTSE UK All Stocks Gilt	2	6	0.3	20	1,146
iShares FTSE UK Dividend Plus	4	10	1.7	40	566
iShares FTSE/EPRA European Property Fund	8	45	23.0	40	423
iShares FTSE/Macquarie Global Infrastructure	7	16	5.2	65	250
iShares FTSEurofirst 100	4	19	9.2	40	46
iShares FTSEurofirst 80	7	25	14.6	40	35
iShares Markit iBoxx \$ Corporate Bond	0	2	0.1	20	1,134
iShares Markit iBoxx £ Corporate Bond	1	2	0.2	20	1,328
iShares Markit iBoxx Euro Corporate Bond	1	4	0.2	20	3,145
iShares MSCI AC Far East Ex-Japan	8	11	4.7	74	1,374
iShares MSCI Eastern Europe 10/40	7	15	14.1	74	230
iShares MSCI Emerging Markets	5	7	5.3	75	4,246
iShares MSCI Europe	6	19	11.7	35	1,353
iShares MSCI Europe Ex-UK	8	22	17.5	40	519
iShares MSCI Japan	4	15	1.6	59	1,550
iShares MSCI Japan SmallCap	66	81	19.0	59	84
iShares MSCI Korea	4	13	4.8	74	389
iShares MSCI North America	3	5	2.4	40	1,528
iShares MSCI Turkey	22	46	25.1	74	175
iShares MSCI World	4	8	4.8	50	3,254
iShares S&P 500	0	12	0.5	40	7,996
iShares S&P Global Clean Energy	28	38	170.9	65	84
iShares S&P Global Water	2	8	3.5	65	140
iShares STOXX Europe 50	5	18	12.0	35	520

iShares German ETFs 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM *Mil Eur
iShares ATX (DE)	5%	10%	2.4	32	37
iShares DAX® (DE)	0%	1%	0.3	16	11,625
iShares DivDAX® (DE)	0%	3%	0	31	249
iShares DJ Eurozone Sustainability Screened (DE)	0%	3%	0	41	53
iShares eb.rexx® Government Germany 10.5+ (DE)	47%	100%	3.1	15	97
iShares eb.rexx® Government Germany 1.5-2.5 (DE)	29%	78%	1.4	15	1,187
iShares eb.rexx® Government Germany 2.5-5.5 (DE)	50%	97%	2.7	15	798
iShares eb.rexx® Government Germany 5.5-10.5 (DE)	51%	100%	3.1	15	678
iShares eb.rexx® Government Germany (DE)	46%	98%	2.6	15	690
iShares eb.rexx® Jumbo Pfandbriefe (DE)	10%	23%	0.7	9	1,291
iShares eb.rexx® Money Market (DE)	51%	100%	3.2	12	613
iShares EURO STOXX 50 (DE)	0%	3%	0	16	2,509
iShares EURO STOXX Banks (DE)	1%	10%	3.7	51	200
iShares EURO STOXX (DE)	1%	2%	1.2	20	501
iShares EURO STOXX Select Dividend 30 (DE)	2%	9%	2	31	230
iShares Markt iBoxx® Euro Liq Sov Cap 10.5+ DE	7%	13%	1	16	15
iShares Markt iBoxx® Euro Liq Sov Cap 1.5-10.5 D	13%	24%	0.9	15	71
iShares Markt iBoxx® Euro Liq Sov Cap 1.5-2.5 DE	10%	23%	0.8	16	71
iShares Markt iBoxx® Euro Liq Sov Cap 2.5-5.5 DE	11%	20%	0.8	15	70
iShares Markt iBoxx® Euro Liq Sov Cap 5.5-10.5 D	12%	21%	0.8	16	52
iShares MDAX® (DE)	3%	5%	3.1	51	759
iShares Nikkei 225® (DE)	0%	0%	0.1	51	154
iShares STOXX EU Enlarged 15 (DE)	1%	9%	0.2	51	11
iShares STOXX Eur 600 Construction&Materials (DE)	0%	1%	0	50	10
iShares STOXX Europe 50 (DE)	0%	3%	0	35	282
iShares STOXX Europe 600 Banks (DE)	0%	5%	1.6	49	146
iShares STOXX Europe 600 (DE)	0%	1%	0.7	20	1,380
iShares STOXX Europe 600 Health Care (DE)	0%	1%	0	50	175
iShares STOXX Europe 600 Oil & Gas (DE)	0%	4%	0.1	45	147
iShares STOXX Europe 600 Real Estate (DE)	1%	5%	0.2	47	77
iShares STOXX Europe 600 Utilities (DE)	0%	7%	0	49	67
iShares STOXX Europe Mid 200 (DE)	1%	2%	2.1	20	101
iShares STOXX Europe Select Dividend 30 (DE)	0%	3%	1.1	31	118
iShares STOXX Europe Small 200 (DE)	2%	4%	4.9	20	139
iShares TecDAX® (DE)	7%	11%	52.2	50	65

Source: BlackRock. Data to end December. * AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average NAV of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total NAV lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

PowerShares

Invesco PowerShares offers 16 physical ETFs in Europe, but only one is currently involved in securities lending, the PowerShares EQQQ.

All PowerShares' funds are domiciled in Ireland.

Counterparties

The fund's securities are lent to a restricted list of broker-dealers who meet credit rating standards set out by PowerShares. Counterparties must have a minimum rating of A2/P2.

Bank of New York Mellon (BNY Mellon) acts as the securities lending agent.

Risk Mitigation

PowerShares accepts only cash (which is not reinvested), US government securities and US government-backed repurchase agreements as collateral. No margins are applied. Collateral is held in a segregated account.

Lending agent BNY Mellon provides 100% borrower default indemnification. In the event a borrower defaults, BNY Mellon will provide the cash value of the unreturned securities to PowerShares who will then repurchase the securities at no cost for the fund (transaction costs will be covered).

PowerShares 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM *Mil Eur
PowerShares EQQQ	1.21%	n/d	5.2	30	813

Source: Invesco PowerShares. Data to end December. * AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

SPDR ETFs

European-domiciled SPDR ETFs started to engage in securities lending in 2005. Currently, 12 out of a total of 41 funds are involved in this practice.

All European-domiciled SPDR ETFs are physically-replicated funds domiciled in Ireland and France.

Revenue Sharing Arrangement

The fund shareholders receive 70% of the gross revenue generated from securities lending, while the lending agent retains the remaining 30% to cover all the related costs (including the indemnity).

The fee split is determined largely based on anticipated revenue generation which is a function of the portfolio composition and market demand for its assets. As is common in an agent lending programme, the borrower rebates are paid from income generated by the cash collateral account.

Disclosure

PowerShares produces monthly reports available to institutional investors upon request. These reports contain details of loan activity, type of collateral received and collateral levels achieved, investment details and earnings.

Additional summary reports offer a higher level review of both daily and monthly activities.

Securities Lending Activity by Fund

PowerShares has set a voluntary limit of 33% for the amount of assets that can be lent out by its EQQQ fund.

Counterparties

State Street Securities Finance (SSSF) group acts as the lending agent for SPDR ETFs.

SSSF monitors the creditworthiness of the borrowing counterparties and only enters into transactions with approved counterparties that also meet the requirements for UCITS funds.

Risk Mitigation

Acceptable collateral includes liquid equities and government bonds that can be easily marked-to-market on a daily basis. They can be components of major stock indices in the EEA, Switzerland, Canada, Japan, Australia, New Zealand, or the US.

Eligible fixed income securities include government bonds from Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, the Netherlands, New Zealand, Norway, Sweden, UK, or US. SPDR ETFs do not accept cash collateral.

Minimum additional margin requirements are between 2% to 5% depending on the assets being lent and the collateral type and quality. State Street does not rehypothecate collateral.

Lending agent SSSF offers indemnification against collateral insufficiency in the event of a borrower default. This means that in the event of a default, it is SSSF's responsibility to manage the liquidation of the collateral held and subsequently replace the loaned securities. The indemnity covers any shortfall between the value of the collateral and the replacement cost of the securities.

Revenue Sharing Arrangement

The total revenues generated through lending the underlying securities of any participating fund are split with the SPDR ETF receiving 60% of the gross income and the lending agent receiving 40% (before January 2012, the split was 50/50). The lending agent is responsible for all costs associated with arranging lending transactions and administering collateral. The cost of the borrower default indemnification is also covered out of State Street's fee split.

Disclosure

Monthly securities lending reports are available on the company website (on fund detail pages of the participating ETFs). These reports include the 12-month rolling average and maximum on loan, net return in basis points, collateralisation levels, collateral parameters and composition.

Securities Lending Activity by Fund

State Street introduced an on-loan cap of 70% in February 2012 to bring the securities lending programme in line across fund domiciles and fund ranges.

SPDR ETFs do not currently lend fixed income securities as part of its securities lending programme.

SPDR 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps	AuM *Mil Eur
SPDR MSCI Europe ETF	17	31	18	30	324
SPDR MSCI Europe Energy ETF	22	58	26	30	22
SPDR MSCI Europe Materials ETF	12	33	47	30	15
SPDR MSCI Europe Industrials ETF	20	34	8	30	12
SPDR MSCI Europe Consumer Discretionary ETF	17	37	4	30	7
SPDR MSCI Europe Consumer Staples ETF	8	32	3	30	33
SPDR MSCI Europe Healthcare ETF	20	52	25	30	55
SPDR MSCI Europe Financials ETF	11	31	64	30	24
SPDR MSCI Europe Inform. Technology ETF	24	52	5	30	7
SPDR MSCI Europe Telecom Services ETF	12	34	9	30	5
SPDR MSCI Europe Utilities ETF	18	42	36	30	9
SPDR MSCI Europe Small Cap ETF	11	15	14	40	7

Source: SPDR ETFs. Data to end December. * AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

UBS

UBS started to engage its physical replication ETFs in securities lending in 2005, and currently 27 out of a total of 44 physical ETFs are engaged in this practice.

UBS's UCITS-compliant physical replication ETFs are domiciled in Luxembourg and Ireland. Those that are non-UCITS ETFs are domiciled in Switzerland.

Counterparties

For its Luxembourg- and Irish-domiciled ETFs, UBS uses State Street as its lending agent. The third-party borrower list of the lending agent is approved by UBS representatives and matches the UBS counterparty list.

The firm's Swiss-domiciled ETFs lend securities to UBS AG on a principal basis, meaning UBS AG is the only borrowing counterparty to the ETFs. The bank then on-lends the securities to third parties.

Risk Mitigation

For Luxembourg-domiciled ETFs, currently acceptable collateral includes equities issued by G-10 countries (except Japan and Italy) plus Austria, Denmark, Finland, Norway and New Zealand, and world equities. Additional margins of 2% and 5% are applied to US equities and international equities, respectively.

Government bonds from the following countries are also accepted: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Netherlands, New Zealand, Norway, Sweden, UK, US. Additional margin requirements vary from 1% to 5%. Collateral is held in a ring-fenced custodian account in the name of the fund and is marked-to-market daily.

State Street provides borrower default indemnification for Luxembourg and Ireland domiciled ETFs. In the event a borrower defaults, State Street will replace the unreturned securities.

For the Swiss-domiciled ETFs, accepted collateral include government securities, liquid equities (with a 15% haircut) and bonds with a minimum rating stipulated by one of the FINMA approved rating agencies. Further concentration limits ensure proper diversification of the collateral portfolio. The daily mark-to-market collateral is held in a segregated collateral account.

Collateral is not lent out.

Revenue Sharing Arrangement

The fee sharing arrangement in place between UBS, State Street and the fund varies on a fund-by-fund basis taking several factors into consideration. Due to contractual agreements, UBS has not disclosed details.

Disclosure

UBS publishes a quarterly report outlining its ETFs' securities lending activities in Luxembourg (and going forward in Ireland) on its website. The report features for each fund: the 12-month rolling minimum, maximum, and average on-loan levels, net returns in basis points and collateral coverage. UBS also discloses collateral parameters, top 20 collateral holdings as well as a full list of collateral holdings.

Securities Lending Activity by Fund

UBS ETFs can lend up to 100%, as stipulated in the respective jurisdictions.

The following Swiss-domiciled ETFs currently participate in the UBS securities lending programme: UBS-ETF SLI Swiss Leader Index, UBS-ETF SMI, UBS-IS – SMIM ETF A, UBS-IS - SPI ETF (CHF) A, UBS-IS - SPI Mid Cap ETF (CHF) A, UBS-IS - SXI Real Estate ETF (CHF) A, UBS-IS - SXI Real Estate Funds ETF(CHF) A. Details on these funds' lending activity are currently not available but will be in due course.

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UBS 2011	Average on Loan%	Maximum on Loan%	Net Return bps	TER bps I/A Share Class	AuM **Mil Eur
UBS-ETF MSCI USA	4	13	0.7	23/35	993
UBS-ETF MSCI Japan	29	82	3.0	35/55	647
UBS-ETF FTSE 100	6	21	1.3	23/30	211
UBS-ETF EURO STOXX 50	15	52	30.9	15/35	593
UBS-ETF MSCI EMU	14	50	23.0	23/40	363
UBS-ETF MSCI World	14	22	6.0	30/45	463
UBS-ETF MSCI Canada	23	47	20.7	33/50	106
UBS-ETF MSCI Europe	8	24	16.0	23/35	38
UBS-ETF MSCI EMU Value	14	42	29.0	-/40	5
UBS-ETF MSCI Pacific ex Japan	30	58	3.2	30/45	87
UBS-ETF MSCI Emerging Markets	17	29	4.4	45/70	163
UBS-ETF MSCI Turkey	2	13	—	43/60	4
UBS-ETF MSCI World Socially Responsible	11	22	2.9	38/55	9
UBS-ETF MSCI North America Socially Responsible	6	18	2.3	33/50	9
UBS-ETF MSCI Europe & Middle East Social Responsible	6	14	4.4	28/45	11
UBS-ETF MSCI Pacific Social Responsible	26	62	1.9	53/70	8
UBS-ETF MSCI Japan Infrastructur	6	21	0.3	43/60	4
UBS-ETF MSCI Europe Infrastructure	1	12	1.4	43/60	3
UBS-ETF EMU Small Cap	2	4	0.8	28/45	3
UBS-ETF STOXX Global Rare Earth	13	33	12.8	40/57	2

Source: UBS. Data to end March 2012. * Combined I/A AuM as of 30/06/2012. Source: Morningstar Direct. Average on-loan percentage (%) is calculated as the average value of loaned securities over the last 12 months divided by the average AuM of the fund over the same time period. Maximum on-loan (%) is calculated as the maximum percentage of the total AuM lent on any single day over the last 12 months. Net Returns to the Fund (%) is the net 12 month securities lending revenue to the fund divided by the average AuM of the fund over the same time period.

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