THE Nigerian STOCK EXCHANGE

RC: 2321

SECURITIES LENDING GUIDELINES OF THE NIGERIAN STOCK EXCHANGE

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SECURITIES LENDING GUIDELINES

1. General Standards

1.1 The Nigerian Capital market has a reputation for the professionalism of the firms that participate in it and their employees. All participants in the securities lending market have a common interest in maintaining this reputation. They also have a common interest in ensuring that the securities lending market operates in a sound and orderly manner. To achieve these aims it is essential that firms and their staff adopt prudent practices, act at all times with integrity, and observe the highest standards of market conduct.

1.1.1. Participants should possess requisite skills and act with due care and diligence. Staff should be properly trained in the practices of the securities lending market and be familiar with these guidelines.

1.1.2. Participants must accept responsibility for actions of their staff.

1.1.3. Market professionals should pay particular attention to ensuring fair treatment for and between clients who are not also market professionals where conflict of interest cannot be avoided.

1.1.4. Participants in the securities lending market should at all times treat the names of parties to transactions as confidential to the parties involved.

1.2. In order for the benefits of the securities lending market to accrue generally to market participants, it is essential that securities lending activity does not distort the market either in borrowing/lending or in the securities themselves. To this end, participants in the securities lending market must not in any circumstances enter into any transactions or holding arrangements designed to limit the availability of a specific security or with the intention of creating a false or distorted market in the underlying securities.

2. Preliminary Issues

2.1. Where relevant, participants should ensure that they have appropriate prior authority from the beneficial owners of the securities, or from a party suitably authorized by the beneficial owners, for the security to be lent.

2.2. All participants should ensure that there are no legal obstacles to their undertaking securities borrowing and lending transactions and that, where necessary they have all relevant permissions from the regulatory authorities. They should become familiar with the rules, procedures and conventions of

the market in which they will operate in order to fully comprehend the business and its associated risk. Participants should ensure that they have established and fully understood their tax position in relation to securities lending transactions. Such transactions should be carried out in accordance with the relevant market and tax regulations.

2.3. Participants should ensure that they have adequate systems and controls for the business they intend to undertake. These should include the following items.

2.3.1. Participants should establish, retain and periodically update their documentation so that it is adequate to cover the types of transactions to be undertaken.

2.3.2. The management of a lending agent firm should maintain a list of those authorized to borrow or lend securities on its behalf and should make this list available to its counterparties on request.

2.3.3. Parties should have suitable internal controls designed to ensure that any securities lent have been properly authorized before securities are delivered against an obligation to lend.

2.3.4. All participants should take steps to ensure that daylight exposure is recognized and properly controlled. Such steps should include controls on the replacement or renewal of collateral.

2.3.5. Clear and timely records should be available to the management of any party involved in securities lending/borrowing showing, *inter alia*, the value of securities borrowed/lent, collateral given/taken and, where appropriate, any fee income received. This information should be available in aggregate and by counterparty to enable accurate monitoring of credit risk.

2.3.6. Parties in securities lending/borrowing transactions should monitor their exposure to their counterparties on a daily basis. Appropriate exposure limits should be maintained for all counterparties and should be reviewed on a regular basis. Particular attention should be paid to any loans which have been made on an uncollaterized basis.

2.4. The following paragraphs of Section 2 of these Guidelines cover procedures which should be undertaken before entering into securities borrowing and lending transactions with a new counterparty.

2.4.1. Participants should ensure that they have agreed documentation and have assured themselves of its effectiveness, particularly, for example, in respect of

non-Nigerian counterparties, and that they have undertaken a thorough credit assessment of the counterparty.

2.4.2. Parties in a securities lending transaction should disclose to their counterparty the capacity (principal or agent) in which they are acting and should also ensure that they are clear as to the capacity of their counterparty. Where the lender is an agent, the parties should agree appropriate arrangements for the identity of the principals on whom the risk is taken to be established before each deal is finalized at least by means of an agreed identification code.

2.5. Before dealing for the first time with a client who is not a market professional, market professionals should either confirm that the client is already aware of these guidelines and its key contents, or draw them to the client's attention.

2.5.1. Market professionals should check whether the new client has a copy of these guidelines and if not, either send them a copy or advise them to contact The Nigerian Stock Exchange (NSE) directly for a copy. Market professionals may also wish to consider arrangements for notifying their client of any updates.

2.5.2. Such market professionals should inform the new client, if they are new to securities borrowing and lending, that these guidelines recommend that:

i. transactions should be under the Securities Lending Legal Agreement or equivalent;
ii. transactions should be marked to market regularly and re-collaterized as appropriate; and
iii. collateral should normally be held independently from the counterparty.

And, if appropriate, the market professional should remind the client that it is for the client to decide if she/he/it needs independent advice.

2.5.3. Such participants should also inform the client that there could be tax `consequences from entering into securities borrowing and lending transactions, in particular with regards to dividends.

2.5.4. Where such participants will be borrowing securities from clients, whether as a final borrower or intermediary, they should make it clear to the lender that any voting rights will be transferred along with title to the securities and the client is not, therefore, entitled to exercise any such rights until the securities are redelivered to it. They may also wish to consider explaining the client's entitlements in relation to any benefits on loaned securities.

3. Lending Agents

3.1. Before dealing with a client for the first time, agents should confirm that the client is already aware of these guidelines and its key contents by drawing them to the client's attention. Agents should represent clearly the nature of the arrangements and the capacity in which they are acting. There should be a clear legal agreement, which may form part of the standard fund management or custody agreement, authorizing the agent to lend securities, setting down terms on which the securities may be lent and specifying the collateral that may be taken.

3.2. An agent shall obtain the necessary prior written authority from the beneficial owners of the security or from a party suitably authorized by the beneficial owners, to undertake securities lending.

3.3. Where a lender is acting through an agent, there should be an agreed arrangement between agent and principal for the safeguarding of collateral and the allocation of any earnings on that collateral.

3.4. An agent should inform the beneficial owners that securities lending involves the absolute transfer of title and that securities on loan cannot therefore be voted by the lender unless they are recalled. They may also wish to consider explaining the client's entitlements in relation to any benefits on loaned securities.

3.5. An agent should make regular reports to clients, providing them with full explanations of the securities lending activity carried out on their behalf.

3.6. Where a participant is acting as an agent for more than one principal, a clear system for determining which principal's asset are on loan should be established. There should be a clear system for determining any allocation of collateral between the principal lenders and for determining their entitlements.

4. Legal Agreement

4.1. All securities lending transactions should be subject to a written legal agreement between the parties concerned. Standard agreements should be used wherever possible.

4.2. The Global MASTER Securities Lending Agreement has been developed as a market standard for securities lending. The Global Master Securities Lending Agreement is referred to in these guidelines as the "Securities Lending Legal Agreement". The Agreement is available on the website of the International Securities Lending Association (ISLA). As of the date of these guidelines, the current version is available at:

http://www.isla.co.uk/uploadedFiles/Member_Area/GMSLA/GMSLA%202010%20Final(3).pdf

4.3. It is strongly recommended that participants entering into a new securities borrowing and lending relationship adopt the Securities Lending Legal Agreement, although they may wish to vary some of its provisions to suit their particular circumstances.

4.4. Participants should consider the need to undertake their own assessment of the legal effectiveness of their agreement, particularly if they have varied important provisions of the Securities Lending Legal Agreement or if the circumstances in which it is to be used are complex.

4.5. The following items in these guidelines should normally be covered by the legal agreement (but the legal agreement will contain other provisions outside the scope of these guidelines):

i. the capacities (principal or agent) in which the parties are acting;
ii. where relevant, confirmation that an agent has appropriate prior authority from the beneficial owners or a party suitably authorized by the beneficial owners, for the security to be lent;
iii. the absolute transfer of the title to securities and collateral (including any securities transferred through substitution or mark to market adjustment of collateral)
iv. daily marking to market of transactions;
v. acceptable forms of collateral and margin percentages (alternatively, these matters may be agreed at the time of the loan and included in the relevant confirmation);
vi. arrangements for the delivery of collateral and for the maintenance of margin whenever the mark to market reveals a material change in value;
vii. provisions clarifying the rights of the parties regarding substitution of collateral;
viii. the treatment of dividend payments and other rights in respect of securities and collateral including, for example, the timing of any payments;
ix. arrangements for dealing with corporate actions;
x. procedures for calling securities and arrangement if called securities cannot be delivered;
xi. clear specification of the events of default and the consequential rights and obligations of the counterparties;
xii. full set-off of claims between the counter parties in the event of default; and
xiii. the governing law and jurisdiction for the agreement.

5. Custody

5.1. Custody is an important aspect of securities lending. Taking possession of the securities or collateral or using a third party custodian removes an important potential element of the credit risks involved, i.e., that, while in procession of the securities/collateral, the other party defaults and the ownership of the securities/collateral subsequently cannot be proved because of administrative error or fraud. This section covers this and other issues relating to custody.

5.1.1. Participants need to ensure that securities loan transactions are identified as such to their custodian. Participants should also take steps to satisfy themselves that their custodian's segregation arrangements are appropriate to the particular circumstances of their activities.

5.1.2. Securities and collateral, including where relevant margin, should be delivered to the account of the counterparty or his agent.

5.1.3. Before agreeing to arrangements in which securities/collateral are left with the other party to the transaction, participants need to consider why they are content to accept such arrangements and why these are prudent. They should consider the credit standing of the other party very carefully. They also need to assure themselves that the other party has appropriate, independently audited, systems and controls for segregating and monitoring securities/collateral.

6. Collateral/Margin

6.1. The loan and the collateral should be marked to market on a daily basis, and more frequently if the need arises.

6.2. The collateral should be delivered to the account of the lender or his agent or a designated third party.

6.3. The agreement should provide for the collateral to be adjusted whenever there is a material change in the value of the currency or securities involved in the transaction and for the original margin to be restored.

6.4. The collateral taken should normally include a margin over the value of the loan which should be specified in the agreement. Alternatively, if this is acceptable to both parties, the margin could be agreed at the time of the loan, when it should be included in the relevant confirmation.

6.5. Securities loans should be made on a collateralized basis against collateral acceptable to the lender, as specified in the agreement or agreed by the parties prior to the loan.

7. Default and Close-out

7.1. Once a decision to declare a default has been taken, it is important, in the interests of the participant, the defaulting party, and the market, that the process is carried out carefully. In particular:

i. the non-defaulting party should do everything within its power to ensure that the default market values used in the close-out calculations are, and can be shown to be, fair; and
ii. if the non-defaulting party decides to buy or sell securities consequent to the close-out, it should make every effort to do so without unnecessarily disrupting the market.

7.2. Parties to a transaction should seek to satisfy themselves that the legal agreement will allow their claims to be offset immediately against the claims of their counterparty in the event of default. Participants may also consider whether it is possible to negotiate alternative arrangements to manage their credit exposures. Particular care will need to be taken in the case of agreements involving lending through an agent.

7.3. Some events, such as insolvency, may be automatic events of default under the legal agreement whilst others may trigger one party's right to declare an event of default against the other. In these latter cases, participants need to recognize that the decision to declare a default is a major one. Senior management of any participant faced with this decision should weigh carefully whether the event which triggers the right requires such action, or is a technical problem which can be resolved in other ways.

8. Confirmations

8.1. Those active in financial markets are fully aware that confirmation and settlement are crucial aspects of any trading operation.

8.2. Market professionals should ensure that a written or electronic confirmation is issued, whenever possible on the day of the trade.

8.3. Participants should ensure that confirmations received are checked carefully as soon as possible, normally on the day of receipt, and that any queries on their terms are promptly conveyed to the issuer.

8.4. Where material changes such as collateral adjustments or substitutions of collateral occur during the life of the transaction, these should be agreed between the parties and may also be confirmed, should either party wish it. Where appropriate, this may be done via a cross reference to the original loan.

9. Market Practice

This provision of the guidelines deals with matters of market practice for securities lending. It is inevitable that market practices will evolve and these guidelines can reflect them only at a particular point in time. There are other practical details which will need to be agreed before transactions are undertaken, usually in negotiating the legal agreement. These matters include:

i. acceptable collateral, margin levels and the collateral method to be used;
ii. collateralization following dividends and other corporate events;
iii. approach to daylight and settlement exposures, and pre-delivery of collateral;
iv. business day conventions;
v. notice periods for elections, recalls and substitutions;
vi. pricing sources for marking to market and currency conversions;
vii. settlement arrangements; and
viii. designated offices.

9.1. It is important, for the purposes of delivery/redelivery of securities and collateral and various notice periods, that there should be a clear agreement between the parties about the meaning of "business days". Participants may wish to vary the usual business day convention to suit their particular circumstances and this variance would need to be reflected in the legal agreement.

9.2. Participants will need to reach an understanding about the latest time on a business day at which a notice or call should be issued in order to be treated as having been given on that day. Market practice is that notices and other such documents should be given before the close of the relevant market. It should be noted that this may well be earlier than the end of the business day.

9.3. The relationship between lender and borrower, and the individual transactions between them, will also be facilitated if there is a clear understanding of each party's attitudes to certain events which may occur during a securities loan. Such matters include:

i. voting on stock that lent or collateral given;
ii. elections and other corporate actions on stock lent or collateral given;
iii. substitutions of collateral; and
iv. intra-day marking to market.

9.4. **Trading**

9.4.1. At the point of trade, participants will need to agree:

i. margin percentages and acceptable collateral and
ii. the essential economic terms of the transaction, in particular the stock to be learn, rate and term; and
iii. any non-standard features of the particular transaction.

9.5. Confirmations

9.5.1. The loan confirmation should contain the following information:

i. loaned securities (type, ISIN and quantity)
ii. lender (underlying principal unless otherwise agreed);
iii. contract date;
iv. borrower (as for lender);
v. lender's bank account details;
vi. borrower's bank account details;
vii. rates applicable to loaned securities;
viii. rates applicable to cash collateral;
ix. delivery dates;
x. term (termination date for term transactions or terminable on demand);
xi. acceptable collateral and margin percentages (if not specified in the legal agreement);
xii. borrower's settlement system and account; and
xiii. lender's settlement system and account.

9.6. Delivery/Re-Delivery

9.6.1. Parties involved in the securities lending transaction should be aware of the procedures for calling securities; also the rights and obligation of each party should be clearly established.

9.6.2. There should be explicit agreement between the parties on the arrangements to be followed if called securities cannot be delivered. The parties should also consider whether arrangements are necessary in order to deal with the possibility of securities or collateral being redelivered too late in the day to enable the recipient to meet an onward delivery obligation.

9.6.3. Parties should ensure that they are aware of the procedures to be followed in the event of failed deals in all markets in which securities are lent; the rights and obligations of each party should be clearly established.

9.6.4. Any party wishing to recall or return securities on loan should have regard to the possible implications for its counterparties and should therefore

notify them as soon as possible. Where a lender intends to recall loaned securities in order to meet part of a sale or delivery obligation, it is good practice, if possible to consider whether the larger sale or delivery obligation can be shaped or partialled so as to avoid any prospect of the whole transaction failing if the borrower cannot redeliver the loaned securities at the designated time.

9.6.5. The legal agreement between participants may provide for the transferee to obtain financial redress if the transferor fails to redeliver borrowed securities or collateral at the designated time. It is advisable for participants to consider and agree at the onset of a new relationship how any such provisions will operate in the event of a failure to redeliver. Such amounts will typically include:

i. costs passed back to the transferee because its counterparty has bought-in securities to cover a failed onward delivery;
ii. interest and overdraft costs which have arisen from the transferee's need to finance an acquisition from an alternative source; and
iii. fines and other penalties suffered by the transferee as a result of its inability to settle onward delivery obligations.

Other forms of potential costs may or may not be covered by the terms of the legal agreement. Where as a result of the transferor's failure to redeliver securities or collateral, the transferee fails to meet a sale or delivery obligation in respect of a larger onward transaction, the norm is for the transferee to seek to recover only that proportion of the costs suffered which relates to the securities/collateral which the transferor has failed to return.

9.6.6. Where such a claim is to be made, the transferee should inform the transferor promptly of that fact and should also provide notification as soon as possible of the amount due and the basis on which it has been calculated so that the transaction can be settled on a timely basis. The transferee should provide appropriate evidence to support the calculations as soon as possible thereafter.

9.7. Collateral/Margin/Marking to Market

9.7.1 The required collateral margin will be negotiated between the parties at a level which reflects both their assessment of the counterparty's credit worthiness and the market risks involved in the transaction.

9.7.2 The norm is for transactions to be marked to market on the basis of end of day prices in the relevant market. Counterparties' credit exposure will also fluctuate intra-day as market prices move and there may therefore be particular circumstances (such as exceptional price movements) in which further valuations and collateral adjustments will be undertaken on an intra-

day basis. Participants will need to agree at the onset whether and in what circumstances, such intra-day adjustments are to be undertaken, and the pricing sources and delivery mechanism to be used.

9.7.3. The degree of exposure which a counter party will regard as material and which will trigger a call for collateral to be provided or returned will be agreed in advance with the other counterparty. The point at which a net mark to market value becomes "material" is itself a credit judgment. This includes the possibility of the two parties agreeing to daily collateral adjustments, irrespective of the size of the exposure that has arisen.

9.7.4. Borrowers should exercise reasonable care in determining the time at which a substitution call is to be made, bearing in mind that some lenders (particularly principal traders and brokers) may not be in possession of the collateral. They are, therefore, encouraged to give lenders as much time as possible of a substitution. Where a borrower intends to recall and substitute collateral in order to meet part of a sale or delivery obligation on a larger transaction, it is good practice, if possible, to consider whether the larger sale or delivery obligation can be shaped or partialled so as to avoid any prospect of the whole transaction failing if the lender cannot redeliver the collateral at the designated time.

9.7.5. Participants will need to agree at the onset how any dividends and other corporate events on borrowed securities or collateral are to be dealt with in the valuation. It is advisable for participants to consider the credit exposures which may arise as a result of such events. Where their assessment indicates that adjustments to the normal calculation may be needed in order to match their particular risk appetite, they may wish to negotiate such arrangements with their counterparty.

9.8. Dividends, Corporate Actions, etc.

9.8.1. Securities Lending involves the absolute transfer of title of both the securities lent and the collateral taken and any voting rights are transferred along with title. Securities must, therefore, be recalled by the lender, or collateral substituted by the borrower, if they wish to exercise the voting rights attached to particular securities. It is the interest of both parties to a securities lending relationship to understand each other's attitudes to voting from the outset.

9.8.2. Lenders need to be aware that, if they lend their entire holding of a particular securities, they may cease to receive information about corporate events in relation to it.

9.8.3. The arrangements to be followed in the event of a rights issue or other corporate action should be clearly established by all parties before a security loan is made.

9.8.4. Arrangements should be made to compensate the lender of securities (or giver of collateral) for any dividend or interest payment due while a particular security is on loan (or collateral is held by the lender). These arrangements should make each party's obligations clear including, for example, the timing of any payments.

9.9 Term Trades

9.9.1. Term trades are used in the securities lending market to describe a wide range of arrangements.

9.9.1. Participants need to agree whether the term of the loan is fixed or indicative. If the term is fixed, there will be no obligation on the lender to accept early return of the securities or on the borrower to comply with a recall request.

9.9.2. Where the securities lending involves cash collateral, the parties should establish whether it is the amount of the specific securities which is fixed or the overall value.

9.9.3. In agreeing to a particular rate, the parties will take into account whether or not the term is fixed and the permissibility of returns and recalls.

9.9.4. Participants where appropriate will also need to reach agreement on the procedure for adjusting if a security is returned early by the borrower or for compensating the borrower in the event of an early recall by the lender.