

# Securities Lending FAQ – Frequently Asked Questions

## INDEX

1) IMPORTANT NOTICE .....	1
2) INTRODUCTION .....	3
3) RULES, PROCEDURES AND COSTS.....	4
4) RISK MANAGEMENT .....	16
5) LEGAL AND TAX ASPECTS .....	24
6) STATISTICS AND RANKINGS .....	27
7) OPERATING QUESTIONS.....	31
ANNEX I - DELIVERY FAILURES PROCEDURES.....	34
ANNEX II - KEY TOPICS ON RISK/COLLATERAL MANAGEMENT .....	36
ANNEX III – TAXATION.....	43

## **1) IMPORTANT NOTICE**

This document has been prepared by B3 S.A. – BRASIL, BOLSA, BALCÃO (hereinafter B3) to foster the development of its securities lending service in order to particularly incentive foreign investor to use it.

A copy of this document may be made available to third parties for information purposes only and should not be viewed or construed as a binding document or be relied upon by any third parties for any purposes.

Only the rules and procedures issued by B3 should be relied upon by any members and non-members and are binding upon B3, in addition to any applicable laws, rules or regulations enacted by any regulator with jurisdiction over B3.

Therefore, in case of any discrepancies between any statement, conclusion or comment contained in this document vis-à-vis any rule or procedure enacted by B3, such rule or procedure shall prevail.

Moreover, the content of this document is intended for information purposes only and must not be interpreted as any kind of investment recommendation.

The rules and procedures mentioned herein are subject to modifications, be advised to consult updated versions.

The information contained herein may not be used for commercial purposes without B3's prior written consent.

## 2) INTRODUCTION

This document provides an overview of B3, a Brazilian exchange that provides trading and post-trading services, in regard to its securities lending services, as well its role as central securities depository (CSD) and central counterparty (CCP) for securities subject to securities lending services.

This CSD and CCP role is performed by b Central Securities Depository and B3 Clearinghouse, respectively. The B3 Clearinghouse qualify as systemically important according to the Brazilian Payment System (Sistema de Pagamentos Brasileiro, hereinafter SPB) values, principles and rules. Both B3 Central Securities Depository and B3 Clearinghouse are not subsidiaries, but departments of B3.

For purpose of this FAQ, the following abbreviations and terms were considered:

BCB	Central Bank of Brazil
CMN	National Monetary Council
CVM	Securities and Exchange Commission of Brazil

### **3) RULES, PROCEDURES AND COSTS**

**WHAT ARE OFFICIAL RULES AND PROCEDURES DEVELOPED AND DISCLOSED BY B3 APPLICABLE TO ITS SECURITIES LENDING SERVICES?**

[http://www.b3.com.br/en\\_us/regulation/regulatory-framework/regulations-and-manuals/](http://www.b3.com.br/en_us/regulation/regulatory-framework/regulations-and-manuals/)

**CLEARINGHOUSE RULES. AVAILABLE AT:**

<http://www.b3.com.br/data/files/D7/D2/E0/DF/FAAA26103B55AA26790D8AA8/BMFBOVESPA%20Clearinghouse%20Rules%20--%2020180409.pdf>

**CLEARINGHOUSE OPERATING PROCEDURES MANUAL. AVAILABLE AT:**

[http://www.b3.com.br/data/files/AA/D2/98/78/1BAA26103B55AA26790D8AA8/BM\\_FBOVESPA%20Risk%20Management%20Manual%20--%2020180409.pdf](http://www.b3.com.br/data/files/AA/D2/98/78/1BAA26103B55AA26790D8AA8/BM_FBOVESPA%20Risk%20Management%20Manual%20--%2020180409.pdf)

**CLEARINGHOUSE RISK MANAGEMENT MANUAL. AVAILABLE AT:**

[http://www.b3.com.br/data/files/AA/D2/98/78/1BAA26103B55AA26790D8AA8/BM\\_FBOVESPA%20Risk%20Management%20Manual%20--%2020180409.pdf](http://www.b3.com.br/data/files/AA/D2/98/78/1BAA26103B55AA26790D8AA8/BM_FBOVESPA%20Risk%20Management%20Manual%20--%2020180409.pdf)

**CENTRAL DEPOSITORY RULES. AVAILABLE AT:**

<http://www.b3.com.br/data/files/AD/95/7B/D3/8697061099BE5706790D8AA8/BMFBOVESPA%20Central%20Depository%20Rules%20-%2020170828.pdf>

**CENTRAL DEPOSITORY OPERATING PROCEDURES MANUAL. AVAILABLE AT:**

[http://www.b3.com.br/data/files/CF/95/6D/D3/8697061099BE5706790D8AA8/BM\\_FBOVESPA%20Central%20Depository%20Operating%20Procedures%20Manual%20-%2020170828.pdf](http://www.b3.com.br/data/files/CF/95/6D/D3/8697061099BE5706790D8AA8/BM_FBOVESPA%20Central%20Depository%20Operating%20Procedures%20Manual%20-%2020170828.pdf)

THE INFORMATION INDICATED BY THIS DOCUMENT DOES NOT SUBSTITUTE THE ORIGINAL RULES, PROCEDURES AND COSTS INVOLVED WITH SECURITIES LENDING SERVICE PROVIDED BY B3 PURSUANT TO ITS RULEBOOKS AND MANUALS MENTIONED, AS WELL AS ANY CIRCULAR LETTER DISCLOSED BY B3 RELATED TO THIS MATTER.

## **WHAT ARE FEE RATES FOR SECURITIES LENDING TRANSACTIONS IN B3?**

Securities lenders earn a freely negotiated fee for lending securities. The fee is paid to lenders net of withholding income tax.

A borrower is required to pay both the lender's fee and a transaction fee owed to B3. Currently, this transaction fee is charged at a rate of 0.25% per annum calculated over the loan amount, i.e., the financial value of the borrower's open interest position, provided a minimum BRL 10.00 fee applies. Where the automatic securities lending program is activated (further details below), the transaction fee is charged at 0.50% per annum and no minimum fee applies, also paid by the borrower.

## **HOW DO WE CALCULATE AND PAYOUT THE LENDING FEES?**

Payment for the loan is calculated in form of a fee rate calculated as follows: *Rate of interest to the borrower x number of securities x average quote for the security.*

The fee rate is calculated on compounded basis of a 252 business days count convention. The lending fee will be paid on the contract's expiration date or the settlement date in case of early settlement request.

The average quote for a security is determined at the time the loan agreement is registered, and may be established on the basis of either:

- The average quote at the close of the prior trading session as of the loan registration date.

## **WHAT PROCEDURES APPLY IF THE BORROWER IS UNABLE TO BUY SECURITIES AND RETURN IT TO THE LENDER AT THE END OF A LOAN?**

Securities lending settlement is part of the multilateral netting settlement of B3 Clearinghouse. So, if there is a failure to deliver the securities, the clearinghouse will:

- Charge the value of the non-delivered securities (qty \* price) from the lender and pay to the non-receiving party – the price considered to calculate the payment is the last closing price of the security;
- Postpone the delivery obligation and rights to next business day;
- Charge a fine from the defaulter.

On next business day, the clearinghouse will try to settle again. If the security is still not available in the borrower account to be delivered, then the clearinghouse will:

- Charge a fine from the defaulter;
- Issue a buy-in.

The buy-in represents the right of the non-receiving party to buy at market prices the security non-received. If there is price variation, the borrower will be charged of the difference that is credited to the lender.

If the buy in is not executed in two days, the clearinghouse will cash settle the rights and obligation, comparing the closing price of the previous day of the failure delivery and the closing price of the day before the cash settlement. If there is a difference the borrower will be charged.

## **ARE THERE LIMITS ESTABLISHED FOR TIME-TO-MATURITY AND SETTLEMENT PERIOD?**

Securities loans may be agreed for a specified term as short as one day and there is no requisite maximum term to maturity.

In addition, while lender and borrower may freely negotiate time to maturity, time-to-settlement must be at least T+1 (where “T” means the transaction date).

However, where the automatic securities lending program is activated, it is possible for the borrower to promptly return equivalent securities settling the transaction at “T+0”.

## **IS IT POSSIBLE TO RENEGOTIATE THE LENDING FEE DURING THE LIFE OF THE AGREEMENT?**

Yes, a fee renegotiation is permitted according to renewal of securities lending agreements procedure, as long as lender and borrower, and their custody agents agree on the new terms. In order to be implemented, the renewal request is subject to risk assessment by the clearinghouse.

## **WHAT TYPES OF STANDARD SETTLEMENT ARRANGEMENTS ARE AVAILABLE FOR SECURITIES LENDING AGREEMENTS?**

There are two types of standard settlement arrangements, which are related to the right of early return or recall, as follows:

- **Returnable** – For loans that include an early return option, settlement may take place sooner than anticipated if the borrower chooses to return equivalent securities to the lender earlier than at maturity.
- **Returnable / Recallable** – For loans that include both an early return option and a recall option, settlement may take place sooner than anticipated either

because the borrower chooses to exercise the early return option, or otherwise because the lender recalls equivalent securities from the borrower.

Early return by the borrower may be executed up to 7:00 p.m. On the expiration date of the contract or on the expiration date of the request for early settlement by the lender, full or partial settlement shall be executed by 7:00 p.m.

Early settlement by the lender follows the procedure above:

- For requests made up to 9:30 a.m. the borrower must execute settlement of the contract by 10:00 a.m. of T+2 from the request date; and  
For requests made after 9:30 a.m. the borrower must execute settlement by 10:00 a.m. of T+3 from the request date.

## **WHAT TYPES OF SECURITIES ARE ELIGIBLE FOR LENDING AND BORROWING?**

Currently, securities eligible include stocks admitted for trading on the stock market, ETFs (exchange-traded index funds) and sponsored BDRs (Brazilian depositary receipts).

The Securities eligible for Securities lending Transactions include shares issued by public companies admitted for trading on B3's and other Securities at the Clearinghouse's discretion. The Securities involved in lending transactions must have been previously deposited in the Clearinghouse's Depository Service. The Securities must be free and clear of any liens or encumbrances that may restrict their circulation and their holders must have contractually consented to Transactions of this kind.



## **DO SECURITIES LENDERS RETAIN RIGHTS TO PAYOUTS OR OTHER CORPORATE ACTION EVENTS?**

Strictly speaking, when a security is loaned, the title and the ownership are transferred to the borrower, such that the issuer will not be making direct payments to the lender. However, the borrower refunds the lender (and the securities lending system is programmed to process the refund) for payouts, at the same amounts and dates as cash distributions are paid out by the issuer. This means that at the payment date set by the issuer, the system will credit the lender for the payout amount (as adjusted to account for any withholding tax charges).

Based on the premise of making the lender “whole” for any corporate action event, in the case of cash distributions (e.g., interest on capital, dividends), the lender retains right to be paid cash in the equivalent of any payouts, as if the securities were not on loan.

Where a corporate action event affects the number of outstanding securities of the issuer (e.g., bonus stock distributions, stock splits, reverse splits), the number of securities delivered to the lender at the end of the loan will have been adjusted to account for the effects of the relevant corporate action event.

However, the voting rights inherent in shares on loan are not retained by a lender; rather, they are transferred to the borrower along with the title and ownership.

## **WHAT IS THE TREATMENT APPLICABLE TO CORPORATE ACTION EVENTS?**

### **AUTOMATIC CORPORATE ACTIONS**

#### **Corporate Actions in Cash – Distributions of Dividends and Interest on Capital (“IOC”)**

Distributed dividends and IOC are treated as a refund to the lender. Dividends and IOC over securities on loan and not on loan are paid on the same payment date announced by the issuer.

The financial value associated with the corporate action is calculated by the clearinghouse, considering the registration information of the lender investor, such as type of investor for tax purposes.

On the date of payment of the event, after receiving the corresponding cash funds from the issuer, the borrower investor is debited at the gross amount of income tax and the lender investor is credited at the net amount of income tax in the multilateral settlement window.

Example: On April 5, an issuer distributes BRL 1.00 per share by way of dividend and sets May 4 as the dividend payment date. For holders of a lending position at April 5, B3 provisions a dividend payment, requiring the borrower to secure payment by posting additional collateral. On May 4, the dividend amount is charged to the borrower's account, money is received and passed on to the lender.

#### **Corporate actions without changing the underlying asset**

The position quantity is changed, following the percentages established by the issuer.

## Corporate actions changing the underlying asset<sup>1</sup>

Where a corporate action results in only one asset, a new position is generated, following the percentages established by the issuer.

Where a corporate action results in more than one asset and the new asset is available in the lending system, new agreements are created as many are the assets generated.

If the issuer establishes a portion to be paid in cash, the clearinghouse operates the settlement of such portion in the multilateral net balance on the date of payment of the corporate action by the issuer.

## Corporate actions automatically generating rights in the B3 central depository - subscription rights

- Subscription rights for securities lending positions are processed as follows: T+0<sup>2</sup> to T+5: the lender investor has five (5) business days to request the relevant rights to be returned
- T+6: a closing call will be conducted to price the subscription rights. If the price thereof is not set in the closing call, B3 will calculate and disclose the relevant price, which will take into account the subscription features.
- T+9: the settlement of the transactions executed in the closing call will be processed. Also on that date the subscription rights will be returned by the borrower to the lender who submitted the relevant request.
- T+10: the lender investor who submitted a request for the return of the subscription rights but did not received the relevant rights on the previous

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<sup>1</sup> The processing described in this item applies when the new underlying asset(s) resulting from the event:

(i) Is (Are) listed and traded in a trading environment managed by B3;

(ii) May be deposited in the B3 central depository;

(iii) Has (have) a sufficiently similar volatility to that of the original asset, at the sole discretion of B3; and

(iv) Has (have) a sufficiently similar liquidity to that of the original asset, at the sole discretion of B3.

<sup>2</sup> Date the asset is updated in the B3 central depository

business day is allowed to choose, through the relevant full trading participant or settlement participant, between (a) the receipt of the financial value associated with the subscription rights, or (b) the registration of the agreement as a subscription warrant.

- **Date of Subscription:** the clearinghouse system registers the agreement as a subscription warrant with a time limit of one hundred eighty (180) days, for the cases where the lender investor has decided to choose this alternative, and makes the financial entries for the corresponding subscription value, by debiting the borrower investor and crediting the lender investor.
- **Date of ratification of the Subscription:** the agreements registered as subscription warrants are converted into agreements in the asset underlying the subscription. Such agreements expire four business days after the date of subscription ratification.

## **VOLUNTARY CORPORATE ACTIONS**

### **Tender Offers**

The lender investor in a securities lending agreement wishing to participate in a tender offer must early settle the relevant agreement, subject to the latter's reversal feature, in time to receive the assets and deposit them in a specific subaccount with the B3 central depository for the auction. In this process, the lender investor must consider settlement time frames and possible asset delivery failures.

### **Priority offerings of assets**

The lender investors wishing to participate in any such offering must indicate their interest and it may also indicate a maximum price or a minimum rate, in the case of public offers of debentures containing a priority clause. On the settlement date of the offering the clearinghouse generates the agreement at the requested quantity and makes the required financial entries, by debiting the lender investor and crediting the borrower investor at an amount equal to the product of the quantity in the agreement by the offering price. Said agreement expires four business days after the settlement date of the offering.

If the underlying asset is not available in the securities lending system, the processing to be extended to eligible lender investors will be exclusively financial.

### **Voluntary conversions of asset**

The lender investors may submit a request for the early settlement of their lending agreements, provided the latter include a reversal feature, in time to take part in the asset conversion via the B3 central depository.

Alternately, if the asset resulting from the conversion is available in the securities lending system, the lender investors may submit a request for the conversion of their agreements. The participants responsible for the borrower investors will be advised of such request.

On the date of ratification of the conversion, the still active agreements for which a conversion request was submitted are converted by employing the conversion factors announced by the issuer.

## **WHAT IS AUTOMATIC SECURITIES LENDING CONTRACT?**

Automatic securities lending contract means the compulsory loan of securities utilizing the securities lending service, triggered by the clearinghouse to deal with delivery failure detected after the end of the securities delivery period. It is one of the mechanisms used by the clearinghouse to mitigate liquidity risk associated with securities delivery in spot transactions.

Thus, in the event of delivery failure, the automatic securities lending program is activated to track unfilled loan orders whose features as to size and loan term adequately accommodate the short seller's delivery obligation.

Where more than one such loan order is outstanding, the system selects those which offer lower lending fee rates.

Thus, an investor in default of its obligation to deliver securities will take a borrowing position in like securities so as to deliver them to counterparty, consummating the original trade.

From this standpoint, securities lending plays a major part in the efficient functioning of settlement processes and the securities markets.

## **WHAT IS A NON-STANDARD SECURITIES LENDING AGREEMENT?**

A Non-Standard Securities Lending Agreement differs from a standard form agreement in that while presenting similar features, it also contains provisions designed for market makers and stabilization agents to implement block trading strategies.

## WHAT IS THE TYPE OF SECURITIES LENDING ORDER ENTRY?

Securities lending and borrowing orders may be public or private, as follows:

- Public orders: are made public and can be looked up and acted on by other participants; and
- Private orders: are only made available to the participant indicated in the relevant order.

An order can be either certified or uncertified, as described below.

- Certified order
  - Certified lending order: when entering a certified lending order, both a regular account and the free subaccount must be designated. After the order is authorized by the custody agent, the clearinghouse transfers the assets in the free subaccount to the securities lending subaccount (2801-0), from which the assets cannot be moved out.  
If the free subaccount balance is not sufficient when the order is accepted, the clearinghouse automatically rejects the order entry.
  - Certified borrowing order: when entering a certified borrowing order, a regular account must be designated.
- Uncertified order:
  - Uncertified lending/borrowing order: when entering a lending order, it is not necessary to designate the investor's account, but the order cannot be anonymous. When entering the lending order, the clearinghouse does not check for the availability of balance and does not transfer the assets in the free subaccount to the securities lending subaccount (2801-0).

## **4) RISK MANAGEMENT**

### **WHAT IS THE CREDIT RISK UNDERTAKEN BY SECURITIES LENDERS?**

B3 acts as central counterparty in securities lending transactions registered in the securities lending service managed by B3. There are no links between the investors who borrow securities and investors who lend securities.

B3 requires the borrowers to post collateral before the CCP in order to take any borrowing position so as to ensure a successful outcome for securities loans

### **WHAT LEVEL OF COLLATERAL IS REQUIRED FROM A SECURITIES BORROWER?**

At the outset of a loan, the borrower is required to post collateral for 100% of the principal amount of the loan (value of the loaned securities) plus an additional amount to cover:

- Potential exposure to future fluctuations in the market price of the security (market risk). In CORE methodology, the closeout of all positions are evaluated over a set of scenarios defined by the B3 Market Risk Technical Committee. Each scenario is a set of risk factors price movements over the holding period (10 days). B3
- Liquidity issues over securities and derivative contracts faced during the closeout process (liquidity risk);
- Credit and debit cash flow mismatch (debits before credits) during the closeout process (cash flow risk).

For risk and margin calculation purposes, it is possible to consolidate the portfolios (including securities lending position) of the same investor registered in separate accounts under the responsibility of the same trading participant, of the



same full trading participant or settlement participant, and of the same clearing member.

Clearing members and brokeragehouses bear co-responsibility with customer borrowers for loan settlement. At the clearing member discretion, this may lead the clearing member to require additional collateral from the brokeragehouse and the brokeragehouse to require additional collateral from a customer borrower.

Before taking a loan position, the lender must have placed the securities in custody at B3's Central Securities Depository.

Similarly, before taking a borrowing position, the borrower must have posted the required collateral (defined by CORE model). During the life of the loan, daily margin calls may be made as a result of mark-to-market adjustments to the value of the loan or changes in the market risk scenarios and liquidity parameters of CORE. For example, if the market price for the security rises, the borrower will be required to make an additional margin deposit.

## **WHAT IS THE CALCULATION METHOD USED IN DETERMINING MARGIN REQUIREMENTS?**

Margin is calculated according to the CORE (CloseOut Risk Evaluation) methodology, which is based on scenarios for price variation of primitive risk factors. Said scenarios are defined at levels that ensure a confidence level for the margin model of at least 99.96%.

Chapter 7 of the B3 CLEARINGHOUSE RISK MANAGEMENT MANUAL provides a description of the CORE methodology for determining margin requirements.

## WHAT ARE THE FINANCIAL ASSETS ACCEPTED AS ELIGIBLE COLLATERAL?

The collateral deposit to the clearinghouse must be made in local currency, but it may be replaced by the deposit of other assets and currencies, at the discretion of the clearinghouse. The following assets are eligible to be accepted by the clearinghouse as collateral, subject to the restriction indicated in, B3 Clearinghouse Risk Management, Chapter 6, section 6.2 – Valuating assets accepted as collateral. and 6.3 – Limits for accepting assets as collateral of:

- Federal government bonds traded in Brazil (federal government bonds)
- Gold as a financial asset
- Shares of stock issued by a publicly-traded company listed on B3
- Certificates of deposit of shares of stock (units) issued by a publicly-traded company listed on B3
- American Depositary Receipts (ADRs) representing stocks eligible to be accepted as collateral (\*)
- Fixed-income securities issued by guarantee issuing banks: (i) Bank certificates of deposit (CDs), (ii) Real Estate Letters of Credit (LCIs) and (iii) Agribusiness Letters of Credit (LCAs)
- US dollars (\*)
- US Treasury bonds (\*)
- German Treasury bonds (\*)
- Bank letters of credit (LCs)
- Exchange-traded fund (ETF) shares traded in Brazil
- Shares of the investment fund *B3 Margem Garantia Renda Fixa Referenciado DI Fundo de Investimento em Cotas de Fundos de Investimento* (FIC)

(\*) Only non-resident of Brazil investors are allowed to post such assets as collateral. For more details about overseas collateral, please refer to chapter 6 of

the B3 CLEARINGHOUSE RULES and RISK MANAGEMENT MANUAL, as well as:

[http://www.b3.com.br/en\\_us/products-and-services/clearing-and-settlement/clearing/risk-management/collateral/collateral-offshore/](http://www.b3.com.br/en_us/products-and-services/clearing-and-settlement/clearing/risk-management/collateral/collateral-offshore/)

Consistent with CORE methodology, the value of posted collateral depends on the whole portfolio (collateral + positions) in which such collateral is assessed. Accordingly, to the same asset can be assigned different values at different portfolios. The minimum value of an asset posted as collateral is disclosed on a daily basis in B3 website. Please refer to:

[http://www.b3.com.br/en\\_us/products-and-services/clearing-and-settlement/clearing/risk-management/collateral/minimum-value-of-the-assets-for-deposit-as-guarantee/](http://www.b3.com.br/en_us/products-and-services/clearing-and-settlement/clearing/risk-management/collateral/minimum-value-of-the-assets-for-deposit-as-guarantee/)

B3 calculates the value of assets posted as collateral on a daily basis. Except for local currency, LCs, CDs, LCIs and LCAs, the assets are valued in accordance with the market risk scenarios for the price variation of the primitive risk factors. Collateral valuation occurs within the margin calculation (CORE) process and depends on the composition of the investor's portfolio (positions and collateral).

Collateral in the form of local currency, LCs, CDs, LCIs and LCAs are not valued based on market risk scenarios. The value of these types of collateral is obtained respectively by the full value deposited, the value warranted by the LC and the issuance value of the CD.

For information on total amounts, per asset class, posted as collateral, please refer to:

[http://www.b3.com.br/en\\_us/products-and-services/clearing-and-settlement/clearing/risk-management/collateral/deposited-collateral/](http://www.b3.com.br/en_us/products-and-services/clearing-and-settlement/clearing/risk-management/collateral/deposited-collateral/)

## HOW IS THE COLLATERAL MANAGEMENT PROCESS IMPLEMENTED?

The registration of a loan identifies the borrower and the lender at the beneficial owner level, which to a degree contrasts to practice in some major international markets, where beneficial ownership identification takes place at the level of the intermediary firm (brokerage firm, clearing member).

Similarly, to the transaction registration process, the post of collateral process requires identifying the final investor posting the collateral. Assets posted by the borrower as collateral are registered in its/his/her name within the clearinghouse collateral system and assigned to collateral accounts in the central depositories of the relevant asset types. The assets remain blocked in these collateral accounts until B3 authorizes the central depository to move / transfer them. The collateral are kept segregated from the assets of B3, of the investor's brokerage house and respective clearing member and of other investors under the same brokerage house and respective clearing member.

## WHAT HAPPENS IF THE BORROWER FAILS TO RETURN A SECURITY AT MATURITY OR WHEN CALLED?

In this event, the borrower will be required to pay a minimum or an additional fine (if such is necessary). The fines below are for the entire cash market and not exclusively the securities lending market:

Day after failure	Minimum fine (applied automatically)		Additional fine <sup>1</sup>	
			Operational	Non-Operational
<b>T+0</b>	0.5% Limited to BRL50k		-	0.5%
<b>T+1</b>	0.5% Limited to BRL50k		-	4.5% <sup>2</sup>

<sup>1</sup> Characterizations of delivery failures (by third parties, operational or non-operational) are described in the rules and internal procedures of the Clearinghouse.

<sup>2</sup> In the case of reoccurrence in six months, the value will be 9.5%.

A description of the delivery failure procedures is detailed in ANNEX I.

Ultimately, as central counterparty clearinghouse, B3 is responsible for ensuring a successful outcome for securities loans, with the lender being paid the lending fee and returned equivalent securities or paid the financial equivalent at the end of the loan. For this purpose, the clearinghouse may proceed to seize collateral posted by the borrower and resort to other levels of its safeguard structure.

### **WHAT SAFEGUARDS (OTHER THAN LOAN COLLATERAL) ARE ADOPTED TO ENSURE SETTLEMENT OBLIGATIONS ARE SATISFIED IF THE BORROWER DEFAULTS?**

Consistent with its central counterparty role, B3 keeps a financial safeguard structure designed to ensure the due settlement of the transactions, including securities lending transactions.

According to B3 CLEARINGHOUSE RULES, Title II, Chapter IV, in the event where the default of an investor causes the default of a trading participant, full trading participant or settlement participant, and clearing member, and provided that all these participants are duly identified to the clearinghouse, collateral posted by the participants and the settlement fund resources are used in the following order, until no further losses remain:

1. Collateral posted by the investor and linked to the trading participant, full trading participant, or settlement participant, and clearing member;
2. Any free collateral posted by the investor through other participants, upon authorization of such participants;

3. Collateral posted by the trading participant and linked to the full trading participant and clearing member;
4. Collateral posted by the full trading participant or settlement participant and linked to the clearing member;
5. Collateral posted by the clearing member, except for its contributions to the settlement fund;
6. The clearing member's contributions to the settlement fund;
7. B3's contribution to the settlement fund;
8. The contributions of the other clearing members to the settlement fund, in proportion to the amount of the contribution of each clearing member; and
9. The B3 cash exclusively earmarked for the clearinghouse.

The financial safeguards system and all risk management processes are continually monitored by B3 and BCB.

## **ARE THERE CONCENTRATION LIMITS FOR POSITIONS IN LOANED SECURITIES?**

Yes. Limits are established for open positions in security lending and are applied to the positions of investors, groups of investors belonging to the same financial conglomerate or acting in concert, full trading participants, or settlement participants. For position limit application purposes, the positions held by a given investor and outstanding under all the full trading participants and settlement participants through which said investor operates are consolidated by instrument.

The policies and parameters associated with position limits are defined by the B3 Credit Risk Technical Committee, which reviews periodically the appropriateness thereof in light of current market conditions.

The parameters are disclosed to the market through the B3 website. For the most updated parameters, please refer to:

[http://www.b3.com.br/en\\_us/products-and-services/clearing-and-settlement/clearing/risk-management/position-limits-query/position-limits-query/](http://www.b3.com.br/en_us/products-and-services/clearing-and-settlement/clearing/risk-management/position-limits-query/position-limits-query/)

For details about position limits for securities lending, please refer to B3 Clearinghouse Risk Management Manual, Chapter 5 – Position limits, specially section 5.3.

### **ARE CREDIT RATINGS ASSIGNED TO B3 AND B3 CLEARINGHOUSE?**

The credit ratings currently assigned to B3 can be accessed at: <http://ir.bmfbovespa.com.br> (Financial Information, Ratings). It is worth mentioning that B3 CLEARINGHOUSE is not a legal entity, but a department of B3.

## 5) LEGAL AND TAX ASPECTS

### WHAT ARE THE RULES THAT MAKE UP THE BRAZILIAN REGULATORY FRAMEWORK FOR SECURITIES LENDING?

The relevant laws and rules that comprises the Brazilian regulatory framework for securities lending services are the following:

#### Laws

Law No. 4,595/1964 - sets forth the structure and organization of the Brazilian financial system and the roles of its agents, including the Central Bank of Brazil (BCB);

Law No. 6,385/1976 ("Brazilian Securities Law") - sets forth the structure and organization of the Brazilian securities markets and the role of its agents, including the Securities and Exchange Commission of Brazil (CVM); and

Law No. 10,214/2001 - provides for the activities of the clearinghouses and the netting and settlement service providers within the scope of the Brazilian payment system (SPB), among other provisions.

Law No. 13,043/2014 – sets forth taxation of securities lending among other provisions.

#### Rules

CVM Rule No. 283/1998 – sets forth the provisions regarding the future settlement markets;

CMN Resolution No. 2,882/2001 – provides for the provisions regarding the payment system, the clearinghouses and the netting and settlement service providers which integrate the payment system;



BCB Circular No. 3,057/2001 - regulates the systems operated by the clearinghouses and the netting and settlement service providers which integrate the payment system;

CVM Rule No. 441/2006 – provides for the rules regarding the securities lending provided by clearinghouses; and

CMN Resolution No. 3,539/2008 - redefines rules regarding the securities lending by clearinghouses and providers of clearing and settlement services.

Federal Revenue Service of Brazil. Rule No. 1,585/2015 – sets forth the income tax applicable to income and net gains gathered in financial and capital markets.

Consistent with the regulatory framework thus provided, this type of business must be operated by a CVM and BCB-licensed clearinghouse which is duly authorized to operate a central counterparty (CCP) clearinghouse and central securities depository (CSD), which shall provide central custody of securities.

Currently, B3 is the only institution authorized to operate a securities lending facility in Brazil.

The rulebooks and manuals of B3 Clearinghouse provide for rules and operating procedures regarding its securities lending services as already mentioned in the beginning of this document. Particularly sections 3.3, 4.1 and 6.6 of B3 Clearinghouse Operating Procedures Manual provides additional information on how we operate the securities lending facility. You may access the mentioned rulebooks and manuals at [www.bmfbovespa.com.br](http://www.bmfbovespa.com.br), Regulation, Regulations and manuals.

In Annex II there is a detailed description of the regulatory framework and the risk management procedures adopted by B3.

## **WHAT ARE THE TAXES LEVIED ON SECURITIES LENDING TRANSACTIONS?**

Taxation is discussed in details in Annex III.

## 6) STATISTICS AND RANKINGS

### WHAT STATISTICAL DATA AND OTHER INFORMATION ARE AVAILABLE TO INVESTORS?

You will find on our information on the following:

#### A – Market data (real-time disclosure)

- Certified and uncertified orders: information will be disclosed for each order (per security), including quantity, expiration date, early settlement (if any), participants, grace period, rates etc. Lender's rates will be displayed as the sum of the Lender Clean Rate (lender's remuneration) and the Lender Broker's Commission. Borrower's rates will be displayed as the Borrower Final Rate resulting from the sum of the Lender Clean Rate (lender's remuneration) and the Brokers' Commissions (lender and borrower).
- Pre-contracts and pre-contract intentions: information will be disclosed for each security, including quantity, expiration date, early settlement (if any), participants, grace period, volume traded, rates etc. Lender's rates will be displayed as the sum of the Lender Clean Rate (lender's remuneration) and the Lender Broker's Commission.

#### B - Website – disclosure on T+1

##### 1 – Average lending fee rates

The minimum, maximum and volume weighted average fees referring to one business day prior to the date of publication with outliers' treatment. Furthermore, the fees are also available in .txt file, which lists the average fees of 1 day of the last 21 business days.

[http://www.bmfbovespa.com.br/en\\_us/services/securities-lending/registered-securities-lending.htm](http://www.bmfbovespa.com.br/en_us/services/securities-lending/registered-securities-lending.htm)

## **2 – Loan outstanding positions**

Overall volume and financial value information (by issuer) for the outstanding position at the close of the last trading session.

[http://www.bmfbovespa.com.br/en\\_us/services/securities-lending/open-positions.htm](http://www.bmfbovespa.com.br/en_us/services/securities-lending/open-positions.htm)

## **3 – Selected historical and statistical data (financial value; volume of securities on loan; number of transactions; distribution of transactions by investor category)**

[http://www.bmfbovespa.com.br/en\\_us/services/securities-lending/volume-and-quantity-of-operations.htm](http://www.bmfbovespa.com.br/en_us/services/securities-lending/volume-and-quantity-of-operations.htm)

### **Outliers's Treatment:**

The average fee for 1 business day is reported with outliers's treatment. The Outliers Treatment Methodology (MTO) aims to purge from its sample the loan rates practiced that have characteristics that will distort the result of calculating the average rate of each asset registered by the market, in order to raise the quality of the indicator to be made available by B3.

For this, statistical techniques are used, following steps: (i) organization of rates by investor (lender and borrower, in an individualized way); (ii) distribution of weighted rates by volume traded; (iii) calculation of the limits and exclusion of the upper and lower orders from a certain confidence interval (iv) recalculation of the volume-weighted average rate without the outliers.

This methodology is called Trimmed Average, in which a certain slice of the data that compose the ends (tails) of the sample base is excluded

The complete methodology can be find in the website (only in portuguese):

<http://www.bmfbovespa.com.br/lumis/portal/file/fileDownload.jsp?fileId=8AA8D0975E207D10015E2A7367A9167E>

## **IS THERE A RANKING OF LENDING AGENTS AND BORROWING BROKERS?**

Yes. A monthly report lists the top intermediary firms (lending agents and borrowing brokers), considering the “average stock of open interest” (the sum of the financial volume of the daily stock of contracts divided by the number of business days of the period consulted).

Report available just for brokerage houses.

## **UTILIZATION RATE INFORMATION – IS IT AVAILABLE?**

Utilization rate is a metric used to gauge the relative level of securities on loan. In other words, it is a measure of total assets lent as a percentage of total assets available to lend. B3 does not calculate or disclose this metric.

## WHERE THE SECURITIES LENDING FEES ARE DISCLOSED?

The table below shows the channels of disclosure of the borrower's fees, as well as their composition:

			BORROWER FINAL RATE <sup>2</sup>		
			LENDER CLEAN RATE <sup>1</sup>	LENDER'S BROKER COMMISSION	BORROWER'S BROKER COMMISSION
WEBSITE <sup>3</sup> (T+1, consolidated)	REGISTERED AGREEMENTS	LENDER			
		BORROWER			
CEI <sup>4</sup> (T+1, per agreement)	REGISTERED AGREEMENTS	LENDER			
		BORROWER			
MARKET DATA (T+0, real time per agreement)	ORDERS	LENDER			
		BORROWER			
	PRE-AGREEMENT AND INTENTION	LENDER			
		BORROWER			

 Fees disclosed separately  Fees disclosed as totals

<sup>1</sup>Only encompasses the rate, no lender's broker commission

<sup>2</sup>Encompasses the sum of the lender clean rate + lender commission + borrower commission

<sup>3</sup>Rates are also available at the website in .txt file, where the average rates are listed for one of the 21 business days.

<sup>4</sup>CEI: investor's electronic channel.

## **7) OPERATING QUESTIONS**

### **CAN THE COUNTERPARTIES ACCESS THE SYSTEM FOR INFORMATION ON THEIR LENDING / BORROWING POSITIONS?**

Yes. You can access the system for information on your lending / borrowing positions through our Investor Electronic Channel at:

[https://cei.bmfbovespa.com.br/CEI\\_Responsivo/](https://cei.bmfbovespa.com.br/CEI_Responsivo/)

### **IS IT POSSIBLE TO CANCEL THE SECURITIES LENDING AGREEMENT?**

A securities loan may only be cancelled on the same date of the contract, and then only if certain conditions are met. These conditions include consent having been given by the participant responsible for the borrower investor, the participant responsible for the lender investor and the custody agent appointed in the custodian indication, if any, must submit a formal request and supporting documentation for the operational error that may have occurred.

In the case of a lending position that is being used for margin credit purposes, the cancellation request is subject to risk criteria, pursuant to the clearinghouse risk management manual.

### **WHAT IS THE TIME GRID FOR THE EXECUTION OF SECURITIES LENDING AGREEMENTS?**

The execution of securities lending agreements follows the timetable below:

- Order entry: by 7:15 PM
- Acceptance of certified lending order with custodian indication: By 7:30 PM of order entry date

- Order cancellation: By 7:15 PM of business day preceding lending expiration
- Pre-agreement generation: by 7:15 PM of order selection date
- Pre-agreement generation with carrying participant appointment: by 6:35 PM of order selection date
- Pre-agreement generation from borrowing order selection or direct pre-agreement submission, with custodian indication of lending order: by 7:15 PM of borrowing order selection date or direct pre-agreement submission

Always considering São Paulo time.

## **IS IT POSSIBLE FOR THE LENDER OR THE BORROWER TO ASSIGN THE AGREEMENT DURING THE LIFE OF THE LOAN?**

As a general rule, it is not possible to assign the agreement during the loan term (assigning the agreement would imply transferring the loan position or borrowing position, as applicable).

However, under certain circumstances some form of assignment may be required. Examples include: a fund merger, or fund winding-up.

Additionally, there may be some type of movement involving loaned securities (though not implying title or ownership transfer) in the case of an account change or change of intermediary firm over the course of a securities loan.

## **WHAT DOCUMENTS ARE REQUIRED TO OPERATE A SECURITIES LENDING TRANSACTION?**

There is a one-off requirement for first-time lenders, borrowers and intermediaries that wish to do business on the securities lending market operated by B3, to sign



certain documents (pursuant to rules on transactions and to operating procedures within the scope of the securities lending facility), as follows:

Instrument of Adherence as Participant of the Securities Lending Facility – required from intermediary firms (broker-dealers, custodians)

Instrument of Consent for Registration of Transactions in the Securities Lending System – required from lenders and borrowers (to be kept on file by the relevant borrowing brokers and lending agents)

## **ANNEX I - DELIVERY FAILURES PROCEDURES**

### **SECURITIES DELIVERY FAILURES ON B3'S MARKETS**

Securities delivery failures are no longer associated to the Securities Lending market:

On “R” (adopt “R” as the settlement day), the clearinghouse opens a compulsory position in the securities lending system (BTB) on behalf of the borrower that has failed to deliver the stock in favor of the lender. If there is not enough securities to be borrowed, the default party (borrower) will be required to pay a fine. After that occurs the definition of the part who will not receive the stock, based on the identification of unsettled creditor instructions algorithm (for more details about this procedure, please refer to B3 Clearinghouse Operating Procedures Manual). Still on this day, the clearinghouse register a failure position in favor of the lender and realizes a cash credit to the lender and a debit to the borrower based on the quantity that was unsettled times the R-1 close stock price.

On the next day, “R+1”, the clearinghouse tries to settle again and if the balance of securities are not enough to fulfill the obligation it opens another compulsory position in the securities lending system (BTB) on behalf of the borrower that has failed to deliver the stock. If the stock in reference does not have sufficient volume that covers the total failure position, the borrower will be required to pay another fine. In addition, the clearinghouse closes the failure position and issues a buy-in order

.

#### **1 – EXECUTED**

The lender may execute the buy-in order for the securities up to R+3 on the Equities Cash Market and up to R+4, up to 06:00 p.m the buy-in execution must be notified to the clearinghouse. All the brokerage fees and price differences will generate a credit to the lender and a debit from the borrower.

## **2 – CANCELLED**

If both parties agree, the buy-in order can be cancelled. That means that the lender should return the amount received when the buy-in was issued (financial settlement) in order to receive the original securities.

No other costs or difference in prices will be due.

## **3 – REVERTED**

If the lender does not communicate the cancellation or execution of the buy-in order to B3, the respective buy-in will be automatically reverted for settlement on T+6.

This means that the securities will be marked to market and any difference in prices will generate a credit to the lender and a debit from the borrower.

Also in this case, difference in price will be calculated based on the financial settlement described above and the market price.

## **ANNEX II - KEY TOPICS ON RISK/COLLATERAL MANAGEMENT**

### **1 – SECURITIES LENDING AND MARKET PRACTICE**

In Brazil's market structure, the securities lending service is regulated and supervised by the Central Bank of Brazil (BCB) and the Securities and Exchange Commission of Brazil (CVM), pursuant to BCB Resolution 3,539 of February 28, 2008, and CVM Instruction 441 of November 10, 2006 (amended by CVM Instruction 466/08). These stipulate that only a clearinghouse previously authorized by the Central Bank of Brazil and authorized by CVM to provide custody services may provide a securities lending service.

The clearinghouse must be authorized by the Central Bank of Brazil pursuant to National Monetary Council (CMN) Resolution 2,882 published on August 30, 2001, and BCB Circular Letter 3,057, published on August 31, 2001. Federal Law 10,214 published on March 27, 2001 is also applicable.

To collateralize securities lending, the borrower must post as collateral securities and assets accepted by the clearinghouse, in a sufficient value to assure the operation's settlement, pursuant to the provisions of Article 4 of Federal Law 10,214/01.

According to Federal Law 10,214/01 – the federal law regarding clearinghouse operations within the scope of the Brazilian Payment System (SPB) – clearinghouses, which are systemically important, must act as Central Counterparties (CCP) and adopt mechanisms and safeguards, such as safety devices and risk control rules to ensure the settlement of transactions. The criteria to determine whether a clearinghouse may be considered systemically important within the Brazilian Payment System are defined by Central Bank of Brazil in its Circular 3,057, of August 31, 2001. Pursuant to these criteria, the B3 Clearinghouse is considered systemically important.

B3 offers CCP services for trades carried out within its trading facilities. The acceptance of a transaction by the clearinghouse represents confirmation that the clearinghouse has assumed the counterparty position for settlement purposes. In the case of securities lending transactions, a new trade is confirmed when the system matches the bid and the offer which originated it and if the borrower has enough collateral to cover the risk of the trade. It is assessed automatically by the securities lending, risk and collateral systems.

To support its role as CCP, the B3 Clearinghouse has risk assessment and control processes that begin with the identification of all final investor's positions. The trade allocation process, through which there is identification of the customer who is the final holder of the transaction carried out on the exchange market, guarantees the identification of positions in a timely manner. B3 rules establish that in securities lending transactions investors must be fully identified at the time of registration. For derivatives contracts, transactions must be identified and allocated in the name of final investors at trading instruction or, at most, until the end of the day (T+0) and for cash market until the next business day (T+1). Please refer to the allocation timetable for details in B3 Clearinghouse Operating Procedures Manual.

The safeguard structure that supports the CCP function of B3 Clearinghouse consists of collateral directly posted with the clearinghouse by the final investor, collateral posted by the brokerage house (it includes the minimum nonoperating collateral), collateral posted by the brokerage house to collateralize cash market transactions (for the accounts set with this collateralization mode for the cash market), collateral posted by the clearing members and B3 to the settlement fund and the share of B3 capital earmarked to support clearinghouse activities.

Collateral requirements are based on CORE methodology, a proprietary risk model that stands out for representing the closeout process in detail, evaluating the whole portfolio and the potential gains and losses incurred over time. Pursuant to its final beneficiary model for all clearinghouses, B3 Clearinghouse

maintains records of each beneficial owner's collateral, avoiding commingling of assets.

B3 operates in a vertically integrated structure. In addition to the settlement and CCP services related to securities lending transactions, B3 also manages a Central Securities Depository (CSD) for equities and corporate bonds. Securities posted as collateral are held in accounts that the B3 maintains at central securities depositories (CSDs). For equities, the B3 Clearinghouse uses its own CSD. For Brazilian government bonds and Bank CDs, it uses the Central Bank of Brazil's Special System for Settlement and Custody (SELIC) and Central Office for Private Securities (CETIP), respectively. Non-resident investors can also post US treasuries, German bonds and ADRs in favor of B3 at DTCC or Euroclear.

Another feature of the transparent holding structure is related to the legal and operational controls that may be implemented to guarantee the segregation of customers' funds from brokers' funds. Fund/collateral transfers are ordered by intermediaries on customers' behalf but, as the positions are identified and controlled at the final beneficiary level, any improper attempt to transfer ownership will be identified and automatically blocked by the clearinghouse systems.

According with Federal Law 10,214/01 and CMN Resolution 2,882, B3 is subject to the regulation and supervision of the Central Bank of Brazil and of the Securities and Exchange Commission of Brazil (for securities transactions).

The identification of positions on a final beneficiary owner level allows B3 to provide regulators with all the information required for the execution of its surveillance activities. B3 provides Brazilian regulators with daily reports on outstanding positions and collateral positions for the derivatives and securities lending markets, segregated by final investor. Any transfer of position or suspicious transaction can be identified by the regulators. Operational control is improved by the provisions stated in CMN Resolution 2,554, of September 24, 1998, which determined the deployment and implementation of internal controls

system, and in Resolution 3,198, of May 27, 2004, which deals with the regulation of independent auditor services. In addition to this, Securities and Exchange Commission of Brazil Instruction no. 505/12 sets forth the obligation of brokerage houses to keep records of their customers and to provide exchanges and clearing organizations with accurate customer data. Securities and Exchange Commission of Brazil Instructions no. 325/00 and no. 419/05 determine that the same rules apply for foreign investors.

As described above, Brazilian market structure and a sound legal framework allow the B3 Clearinghouse to put some important mechanisms into practice to avoid collateral misuse and protect ownership of the securities and assets posted by final investors. Other provision set forth in Federal Law 10,214/01 states that a clearinghouse must establish procedures for the default of its participants. According to this provision, in the event of default the B3 Clearinghouse may use collateral posted by the defaulting participant, regardless of judicial notice. As collateral accounts are kept totally segregated in the clearinghouse's account structure, in cases of participant default the B3 Clearinghouse will specifically execute the defaulter's collateral in order to honor its obligations. Collateral deposited by defaulting participant customers is protected by Federal Law 10.214 and may not be used by the clearinghouse in any way other than that established in the above mentioned Federal Law and in the norms. All default events must be informed to regulators. As the regulators have updated information on positions and collateral, on an individual basis, it facilitates their oversight regarding participant activity that is performed by the clearinghouses.

In cases of default, the B3 Clearinghouse takes the following steps: (i) it closes out positions held by the defaulter; (ii) it uses the defaulter's collateral to cover possible debit balances; (iii) it notifies the market and competent authorities; (iv) it imposes the applicable penalties, pursuant to the provisions in the clearinghouse rulebook; (v) it makes use of other mechanisms to ensure the timely fulfillment of pending obligations.

BCB and CVM follow the financial market infrastructure principles published by the Bank for International Settlements (BIS) and the International Organization of Securities Commissions (IOSCO), particularly when issuing resolutions and instructions.

Therefore, the securities lending service provided by B3, which encompasses Brazilian capital market liquidity, the use of access facilities and the protection of its users, follows normal market rules and practices. Furthermore, its rules and practices (operational procedures) are approved by BCB and CVM in accordance with the respective jurisdictions of these bodies.

## **2 – COLLATERAL OBTAINED UNDER A SECURITIES LENDING AGREEMENT MEET THE FOLLOWING CRITERIA:**

### **MARGIN REQUIREMENTS**

B3 Clearinghouse's margin requirements are calculated using CORE methodology, a proprietary risk model for the calculation of portfolio risk at the customer level (exchange traded positions and OTC positions and collateral). Under CORE methodology, the potential credit exposure is estimated as the worst scenario for the closeout of investor's portfolio upon a default, given a closing strategy, that means, the worst financial loss, arising from the closeout process, considering adverse price movements given by extreme but plausible scenarios for the variation of each risk factor.



## **LIQUIDITY**

Among others, accepted collateral includes cash, Brazilian government bonds, US treasuries, German bonds, ADRs, equities, certificates of deposit, letters of credit and gold.

Positions and collateral are assessed by CORE methodology at the same extreme but plausible market scenarios (for risk factors), accordingly, collateral valuation is inherent to margin calculation. In addition to that, it is worth mentioning that there are volume limits related to specific types of collateral, applicable to issuers, individual participants and/or group of participants acting in concert. The CCP procedures to mitigate liquidity risk (collateral limits, liquidity lines, indirect access to the Central Bank's discount facility and to CCP capital) ensure sufficient liquidity resources in a timely manner in case of participants' default.

## **VALUATION**

Deposited collateral is valued and marked to market at least in a daily basis.

## **ISSUER CREDIT QUALITY**

The risk framework is based on CORE methodology, applying extreme but plausible market scenarios for margin calculation and collateral valuation purposes.

## **COLLATERAL MUST BE ISSUED BY A BODY THAT IS INDEPENDENT TO THE COUNTERPARTY**

This is a statutory obligation. According to Article 30 of Federal Law 6.404/76, “a corporation may not trade in its own shares”. Furthermore, paragraph 3 of the same Article states that a “corporation may not receive its own shares as a guarantee, except to ensure proper management by its officers”.

## **NON-CASH COLLATERAL CANNOT BE SOLD, PLEDGED OR RE-INVESTED**

According to Federal Law 10.214/01, collateral may only be used to assure settlement of transactions. B3 strictly follows the provisions of this law. There is no rehypothecation of assets at B3’s clearinghouses.

## ANNEX III – TAXATION

### Remuneration received by the lender

The lender receives remuneration subject to tax as fixed income in accordance with the rates below:

Holding Period	Rate
To 180 days	22.5%
From 181 to 360 days	20.0%
From 361 to 720 days	17.5%
More than 720 days	15.0%

The tax rates are withheld by B3 taking into consideration the lender's tax condition:

Investor	Rate
Local based Investor and Tax Haven	decreasing rates above
Foreign Investor (4373)	15%
Financial Institutions <sup>3</sup>	not subject to withholding tax
Investment Funds	exempted

### Reimbursement of corporate actions (i.e. dividends, interest on capital and income)

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<sup>3</sup> As well as financial institutions, insurance, private welfare and lottery-linked savings (aka premium bond) companies, brokerage houses, dealers and financial leasing companies are not subject to withholding Income Tax.

The lender receives a reimbursement equivalent of dividends, interests on capital or income distributed by the company that issued the borrowed securities during the loan.

If securities lending refers to stock the reimbursement as dividends and interest on capital shall be full when the lender is not subject to tax and when lender is subject to taxation the reimbursement as interest on capital shall be deducted from the amount as withholding income tax at the same rate applicable if the lender had not lent its stocks.

If the loan refers to bond and other securities lending except stock the reimbursement shall be partial deducted from the equivalent income tax would be applicable to lender or deducted from the equivalent amount of withheld income tax (15%) if these lender is subject to tax and borrower is exempt (i.e. an investment fund or club; or investment of resources set forth in article 5 of Law 11,053/04, a private pension entity, insurance company or Fapi).

#### Loans between a tax-exempt borrower and a lender subject to taxation

The equities' lending transactions between lenders subject to taxation and tax-exempt borrowers are subject to income tax at 15% over the amount as the interest on capital distributed by the company that issued the borrowed stocks.

If the loan between tax-exempt borrowers and subject to tax lenders refers to bond or other securities lending subject to tax as fixed income is due (i) by the borrower income tax at 15% over the income distributed by the company that issued the borrowed stocks and (ii) by the lender income tax calculated as the difference between the of the tax that would be collected if this income were paid directly to him and the amount owed by the borrower (calculated at 15% over the income distributed).

The above-mentioned tax will only be applicable if the borrowers maintain the borrowed security position in custody or lend out their position to third parties (not applicable if the security has been sold). If the investors subject to the above-mentioned tax also own bonds or other securities that had not been borrowed shall be applied an identification of the net amount between borrowed securities from those that had not been borrowed.

#### Sale and subsequent repurchase of securities

If the stock borrower sells the stocks that have been borrowed the difference between sale and the average purchase cost will be considered as net gain or loss of the equity market calculated when the stocks are repurchased.

But if the borrower sells publicly-traded equities (excluding stocks) the positive difference between sale and the acquisition will be considered net gain or loss calculated when the securities are repurchased.

If the borrower sells bonds or securities subject to tax as fixed income the positive difference between the sales (net of the IOF tax) and repurchase is subject to tax as fixed income when the mentioned securities are repurchased.

#### The borrower returning the assets to the lender

There is no taxable event when the borrower returns the same bond, stock or other security of the same class, type and from the same issuer. However, if the transaction is not settled by returning the same asset but by cash delivery, it is subject to tax as net gain or as fixed income. The tax will be calculated considering the difference between cash settlement value of the loan and the average purchase acquisition cost.

## **LEGAL ASPECTS**

**Federal Revenue Service of Brazil. Rule No.1,585/2015** sets forth the income tax applicable to income and net gains gathered in financial and capital markets.

**Federal Law No. 13,043/2014th** sets forth taxation of securities lending among other provisions.