Introduction:
Securities lending is a well-established practice whereby U.S. registered funds, such as mutual funds, make loans of securities to seek an incremental increase in returns for fund shareholders.

This paper explains the basics of securities lending, outlines the benefits and risks for investors, and describes BlackRock’s leading approach to securities lending.

Basics of Securities Lending
In securities lending transactions, mutual funds lend stocks or bonds to generate additional returns for the funds.

Here’s how it works: first, a large financial institution asks to borrow a stock or bond from a mutual fund. In order to borrow the stock or bond, the financial institution will negotiate financial terms with the lending agent of the mutual fund and provide collateral. The mutual fund keeps the collateral to secure repayment in case the borrower fails to return the loaned stock or bond. The value of the collateral is required to be at least equal to the market value of the loaned stock or bond.

The financial institution typically uses the stock or bond to hedge against market risks, facilitate a short sale, or use as collateral in another transaction.

See the flow chart on the next page for an example of how a securities lending transaction works.

In summary:
- While not without risk, securities lending seeks to benefit the fund.
- BlackRock has focused on delivering competitive returns while balancing return, risk and cost in its three decades of lending securities on behalf of shareholders.
- Since 1981, BlackRock has delivered positive monthly lending income for every fund that has participated in securities lending, including mutual funds.

Benefits of Securities Lending
Mutual fund investors can benefit from securities lending in the form of fund performance. How? The mutual fund seeks to generate additional income through the rate that it charges for lending securities (if applicable), and/or income on the reinvestment of the collateral that the borrower provides in exchange for the loan.

Securities lending returns typically vary by asset class and the underlying demand for securities. Of the BlackRock mutual funds that participated in securities lending during the 12-months ended December 31, 2020, approximately 53% of the funds earned less than 0.01%, 31% of the funds earned between 0.01% and 0.05%, 9% of the funds earned between 0.05% and 0.10%, and 7% of the funds earned greater than 0.10% of the total net assets of the fund.
Example of how it works:

To start the process:
1. A large financial institution asks to borrow a stock or bond from a mutual fund. The mutual fund asks for collateral to secure the loan.
2. Once collateral is received, the mutual fund lends the stock or bond to the financial institution (the borrower).

While the security is out on loan...
3. The mutual fund invests cash collateral in a money market fund or private investment company to seek incremental return.
4. If a security pays a dividend or other distribution while on loan, the borrower will pay the mutual fund what the mutual fund would have received if it had been holding such security.

To end the process...
5. At the end of the loan term (or at the mutual fund’s request), the borrower must return the security back to the mutual fund.
6. The mutual fund then releases the collateral back to the borrower to close out the process.

Risks of Securities Lending:
While every investment bears some risk, BlackRock takes a rigorous, hands-on approach to securities lending and has delivered positive lending income for every fund that has participated in securities lending since 1981, including BlackRock mutual funds.

The primary risks of securities lending are borrower default risk and collateral re-investment risk.

Borrower default risk
Securities lending involves the risk that the borrower may default, including by failing to return the securities in a timely manner, or at all. In order to minimize the risk of borrower default, each borrower is assessed by BlackRock’s internal risk department and monitored over time. The risk team performs regular borrower reviews. New transactions are systematically prevented if a borrower reaches its limits.

As an additional safeguard, BlackRock provides an indemnity for its mutual funds for a shortfall in collateral in the event of a borrower default. If a shortfall were to exist between the collateral amount received and the cost to repurchase a loaned security and that shortfall is not due to reinvestment risk, BlackRock would reimburse the fund in full.

Collateral re-investment risk
When a mutual fund receives cash as collateral, it may be re-invested in a money market fund or private investment company with the objective of preserving principal and liquidity while generating income. This re-investment of cash collateral exposes the fund to various investment risks and the potential loss of principal. These risks include market, liquidity and credit risks, and are not covered by BlackRock’s borrower default indemnity. Market risk is the potential for losses due to changing prices. Liquidity risk is the possibility that securities or instruments in which the cash is invested become difficult to sell or can only be sold at discounted prices. Credit risk is the potential that securities or instruments in which the cash is invested default or sell at discounted prices due to changes in credit quality.

To mitigate against these risks, BlackRock invests cash collateral in BlackRock money market funds or private investment companies that invest in diversified pools of high quality, short-term securities and are subject to rigorous restrictions regarding credit quality, maturity and liquidity. BlackRock brings world-class cash management capabilities to bear in this process. As of December 31, 2020, BlackRock is one of the largest money market fund managers in the world with $666.3 billion in cash assets under management.

Since 1981, BlackRock has delivered positive monthly lending income for every fund that has participated in securities lending, including mutual funds.
**Transparency into Securities Lending Practices**

We encourage all investors to ask their fund managers about securities lending practices, and seek information about the fees managers earn or payments they make to third-party lending agents.

Fund shareholders can also find the following in each fund’s Statement of Additional Information (SAI):

- Whether a particular fund is permitted to engage in securities lending
- Disclosure that BlackRock serves as the lending agent, and that it will be paid a fee for the provision of these services
- Confirmation that cash collateral will be invested in a BlackRock money market fund or private investment company; and
- Disclosure of any risk factors and potential conflicts of interest.

In addition, for every BlackRock fund that engages in securities lending, BlackRock publishes securities lending revenues in the fund’s annual shareholder report and SAI and includes a separate line item that details BlackRock’s portion of revenues. In the report and SAI, investors can clearly identify both the fund’s and BlackRock’s earnings from securities lending.

### Q&A

**Q:** How does securities lending benefit the financial markets?

**A:** Securities lending is a vital component of the financial markets. As of December 31, 2020, approximately $29.6 trillion of assets were available for lending globally, with $2.22 trillion on loan.¹

Securities lending increases market liquidity, and in doing so, facilitates transactions, helps to mitigate price volatility, & reduces transaction costs.

Since securities lending transactions can lead to short sales – where investors sell borrowed securities in anticipation of price declines – some have criticized securities lending as a risk to market stability.

In fact, the Federal Reserve has found that short sales can actually improve market stability. Their research has shown that short selling does not systematically drive down asset prices, and that restricting short selling can actually lead to reduced liquidity and higher transaction costs for investors.²

This is driven by the dynamics mentioned above – securities lending and short sales help to improve liquidity and enable investors to hedge risk.

**Q:** Although borrower defaults are infrequent, how well prepared is BlackRock in the event it happens again?

**A:** BlackRock’s integrated technology platform and experienced team of professionals focused on all aspects of markets, trading and liquidity put us in a strong position to manage collateral in the rare event of a borrower default.

Additionally, our securities lending, operations, portfolio management and trading teams regularly assess our readiness to respond to a borrower default using various tools, which in a given year may include a borrower default simulation.

**Q:** Has there ever been a borrower default in BlackRock’s history?

**A:** Since BlackRock’s lending program started in 1981, only three borrowers with active loans have defaulted. In each case, BlackRock was able to repurchase every security out on loan using the proceeds of the borrower collateral received and without any losses to our clients.

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¹ Source: Markit. On loan figure includes market activity for asset owners only.
Q: How is securities lending regulated?

A: Securities lending is a well-established activity and is subject to regulation. The U.S. Securities and Exchange Commission (SEC) is the primary regulator of securities lending activities for mutual funds. SEC rules and guidance govern who can borrow or lend, what types of collateral are acceptable, the levels of collateral, and the reasons for which securities can be borrowed.

Q: What is the maximum percentage of assets that can be on loan?

A: Mutual funds may lend up to $\frac{1}{3}$ of a fund’s total assets, subject to any investment policies and restrictions disclosed in the fund’s registration statement. In practice, many BlackRock mutual funds lend significantly less than that amount and in some cases do not lend at all depending on the assets in the fund’s portfolio.

Q: How much of the securities lending proceeds are paid to the mutual funds?

A: The BlackRock mutual funds have one of two different arrangements, referred to as either “full lending” or “threshold lending.” In the “full lending” program, the mutual funds receive 77–82% of the income generated from securities lending depending on the asset class held. For example, mutual funds that predominantly hold US equities receive 77% of the income from securities lending. All other mutual funds (i.e., fund of funds, and funds that invest predominantly in fixed income or international equities) receive 82% of the income from securities lending.

For funds participating in the “full lending” program, once the aggregate securities lending income exceeds a certain income threshold amount, each mutual fund in the program will receive an increased percentage of the income above original levels, i.e. 81% for US equity mutual funds and 85% for all other mutual funds, for the remainder of the calendar year. The BlackRock closed-end funds participate in the “threshold lending” program. In this “threshold lending” program, the mutual funds receive 82% of the income generated from securities lending on securities where the lending spread exceeds 3% at the time the loan is made (“specials”). Once the aggregate securities lending income exceeds a certain income threshold amount, each mutual fund in the program will receive an increased percentage of the income above original levels, i.e. 85%, for the remainder of that calendar year.

In either program, a BlackRock affiliate serves as the securities lending agent and retains the remainder of the income and the funds bear up to 0.04% in either cash vehicle expenses or cash collateral management fees, as applicable.

From its share of revenues, BlackRock covers all direct operational and custodial costs, including:

Transaction charges and custodial fees. BlackRock pays the transaction charges and custodial fees related to the securities lending transactions along with related market-based charges.

Platform maintenance. BlackRock’s team of securities lending professionals in Delaware, Edinburgh, Gurgaon, Hong Kong, London, New York, Princeton, San Francisco and Tokyo use advanced risk management technology to monitor risks and extract value for our clients. We believe that our proprietary technology is a key differentiator that contributes to strong performance and lower risk.

Indemnity against the risk of collateral shortfall in case of borrower default. BlackRock provides an indemnity against collateral shortfall for mutual fund investors in the rare event that a borrower defaults under a lending agreement, including if a borrower fails to return a security (although BlackRock does not indemnify against cash collateral reinvestment risk). BlackRock’s fees as the securities lending agent are disclosed in the mutual fund’s SAI and financial statements as of the date of such statements.

We encourage investors to ask their mutual fund providers for details on their securities lending program. BlackRock believes investors should evaluate the benefits from securities lending by considering the net returns in light of the associated risks. We periodically benchmark our performance versus competitors using data from independent third-party providers. Over three decades, BlackRock has focused on delivering competitive returns while balancing return, risk and cost.
BlackRock’s Approach to Securities Lending

We believe in managing our securities lending operations on our proprietary platforms and to that end, we have built a proprietary securities lending infrastructure so that our lending agency activity is executed in our clients’ best interests and with prudent risk management.

Skillful risk management

BlackRock has been hired by many of the largest companies and governments in the world to manage risk.

We take a conservative approach and use our proprietary risk and investment management platform, Aladdin, to integrate the capabilities of our dedicated research, trading and risk management teams.

All BlackRock investment and trading teams, across asset classes and around the globe, utilize Aladdin to capture opportunities for our clients in a highly risk-managed environment.

This synergy among securities lending professionals and portfolio and risk management teams enables us to reduce the operational risks of securities lending in a way that a third-party custodian or lending agent may not.

Proprietary technology

Our dedicated team works on custom-built reporting, operations and trading systems to help ensure transparency and operational efficiency.

Our core trading system enables our traders to extract value for our clients in rapidly changing markets by incorporating proprietary trading research and securities lending supply and demand data in a rapid, consistent and scalable manner. Capturing re-pricing opportunities is a key component in outperforming competitors; with tens of thousands of loans outstanding at any given time, our trading system helps ensure that traders focus on the most significant opportunities.

Our proprietary collateral and loan processing application delivers a seamless exception-based process for loan management. While borrower default is rare, the application is designed to manage the default process systematically, and mitigate risk to investors.

Robust assessment of borrowers

We select highly creditworthy borrowers based on conservative credit standards defined by our risk team, which operates independently from our securities lending business.

We continuously monitor the financial performance of borrowers and set individual lending limits for every borrower to help minimize default risk. We monitor all trading activity against these limits and systematically prevent new transactions if the limits are reached.

We also reserve the right to recall a security or require a borrower to provide additional collateral at any time.

Collateral standards

Currently, collateral may include cash or securities issued or guaranteed by the U.S. government. Cash is the most common form of collateral in the U.S. for securities lending. We require borrowers to post initial collateral of at least 102% of the loan value and the mutual fund retains the borrower’s collateral until the borrower has returned the loaned stock or bond.

Careful collateral management

We invest cash collateral conservatively in a BlackRock money market fund or private investment company.

The portfolio management team currently managing the money market funds has acted in advance of credit rating agency downgrades in 106 out of 106 instances over the past decade—eleven months in advance of those defaults, on average.¹

¹ As of December 31, 2020.

Constant monitoring and application of best practices

Since securities lending income is taxed differently than qualified dividend income (QDI), BlackRock closely monitors the impact and tax consequences that securities lending income could have on fund shareholders. We may limit lending activities to ensure that income generated from securities lending does not adversely impact fund shareholders on an after-tax basis.

Conclusion

As the world’s largest asset manager, BlackRock’s priority is acting as a fiduciary to its clients, investors and shareholders. Securities lending is a strategy for funds to seek additional value from their portfolios.

While not without risk, securities lending seeks to benefit the fund. In three decades of lending securities on behalf of clients, BlackRock has focused on delivering competitive returns, while balancing return, risk and cost.

Visit blackrock.com to learn more about how to put BlackRock funds to work in your portfolio.
Risks

Securities lending involves exposure to certain risks, including cash collateral investment risk (i.e., risk that cash collateral investments, whether in cash collateral funds or otherwise, may not achieve their investment objectives, including suffering realized or unrealized loss due to investment performance), "gap" risk (i.e., risk that the return on cash collateral investments is insufficient to pay the rebate fees the lending fund or lending account has committed to pay to borrowers), liquidity risk (i.e., risk that the cash collateral is invested, directly or through the cash collateral funds, in securities and other instruments that are less liquid than the lending fund or lending account, which could limit the liquidity available to the lending fund or lending account for ordinary course transactions), operational risk (i.e., risk of losses resulting from problems in the settlement and accounting process), foreign exchange risk (i.e., risk of a shortfall at default when a cash collateral investment is denominated in a currency other than the currency of the assets being loaned due to movements in foreign exchange rates), and credit, legal, counterparty and market risks. At any particular point in time, investments in the cash collateral funds could comprise a material portion of a lending fund’s assets.

These materials are being provided for informational purposes only and are not intended to constitute tax, legal or accounting advice. You should consult your own advisers on such matters. Additional information is available on request. Information contained herein is believed to be reliable but BlackRock does not warrant its accuracy or completeness. Information contained herein represents BlackRock’s own opinions. There can be no assurance that the investment objectives of any strategy referred to herein will be achieved. An investment in any strategy referred to herein involves a high degree of risk, including the risk that the entire amount invested may be lost.

Forecast

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Securities Lending Returns

BlackRock retains a portion of securities lending returns in exchange for managing the program. This fee reflects risk management, as well as the technology and personnel costs of maintaining the lending platform. In addition, BlackRock receives a fee for the management of cash collateral. Actual lending yields and fees for strategies represented may vary. Please note, other administrative costs, including but not limited to, accounting, custody and audit fees, may vary. Asset spread income is defined as the interest income earned in cash reinvestment funds on collateral balances less the Overnight Bank Funding Rate. Liability spread income is defined as the difference between the Overnight Bank Funding Rate and the rebate rate negotiated with the borrower.

Diversification may not protect against market risk. There is no guarantee that there will be borrower demand for shares of the BlackRock mutual funds, or that securities lending will generate any level of income. Distributions paid out of the funds’ net investment income, including income from securities lending, if any, are taxable to investors as ordinary income. Buying and selling shares of BlackRock mutual funds will result in brokerage commissions.

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