



THE R-INDEX OF CORPORATE GOVERNANCE

INTRODUCING A NEW MEASURE OF

CORPORATE GOVERNANCE

FOR SINGAPORE REITs

A research project conducted by

Patrick LECOMTE (ESSEC Singapore)

for the Asia Pacific Real Estate Association (APREA)

1. Context

The Asia Pacific Real Estate Association (APREA) commissioned Patrick Lecomte (ESSEC Singapore) to undertake a research project on the topic of corporate governance in Asian listed real estate vehicles. For the first stage of this, an analytical framework aimed at scoring corporate governance practices amongst externally managed Singapore REITs has been developed. As the REIT regime has been expanding globally over the last ten years, and in Asia in particular, the effectiveness of corporate governance practices among Asian REITs has become a focus for domestic and international investors alike. The framework presented in this document has been introduced in 2010 and adapted to other Asian countries, most notably Malaysia where the first scores were disclosed in Spring 2011.

2. Corporate Governance Provisions

The scoring framework known as the R-Index encompasses 27 governance factors spanning 8 categories of both external and internal corporate governance. The eight categories listed in order of their weightage on the overall score are: Fees (24%), Board Matters (19%), Related Party Transactions (16%), REIT Organization (15%), Remuneration Matters (8%), Audit Committee (6%), Gearing (6%) and Ownership (5%). Table 1 lists the main corporate governance issues at stake for each category in the framework.

TABLE 1. Corporate Provisions in the R-Index and Main Agency Issues at stake

Categories in the R-Index	Corporate Governance Questions being addressed	Main Agency Issues at stake
BOARD MATTERS	How effective is the Board in monitoring the REIT's activities?	Independence of Board members from Sponsor/ Manager. Diversity and experience of Board members.
AUDIT COMMITTEE	How effective is the Audit Committee in controlling the REIT's activities?	Independence and expertise of the Audit Committee's members.
REMUNERATION MATTERS	Does Director and Executive remuneration policy foster performance, and more generally unitholders' interests?	Transparency and alignment of managers' and unitholders' interests.
REIT ORGANIZATION	How independent is the Manager from the Sponsor? How proactive is the Trustee? How open is the REIT with respect to its activities and policies (AGM, Trust Deed)?	Independence of the Manager from the Sponsor. Ability of Trustee to be part of Checks and Balances. Entrenchment of Manager. Transparency of management policies.
FEES	What is the structure of fees paid by the Trust? Are fees linked to performance? What is the quality of disclosure in the REIT's annual reports? What is the relative level of fees compared to industry benchmarks?	Misalignment of interests between managers and unitholders. Excessive charges born by the Trust due to non performance related fee structure.
RELATED PARTY TRANSACTIONS	What is the quality of disclosure of RPTs in the REIT's annual reports? How involved is the Trustee? What is the role of independent experts?	Transparency and alignment of interests between Sponsor, Manager and unitholders.
GEARING	What is the quality of disclosure? Is leverage compatible with the REIT's ability to generate income?	Excessive gearing due to wrong incentives for Trust Manager (e.g. fees, RPTs) impacting unitholders' returns and investment prospects.
OWNERSHIP	What is the quality of disclosure? How concentrated is the shareholding structure?	Sponsor- Satellite ownership model. Entrenchment of Manager.

Table 2 presents a list of the 27 governance provisions.

TABLE 2. List of Corporate Governance Provisions included in the R-Index

The list below presents the selection of corporate governance provisions included in the R-Index. Figures in parenthesis represent the number of related elements in the R-Index core score.

Board Matters (16)

- 1- Board Composition (1)
- 2- Board Independence (1)
- 3- Nominating and Remuneration Committee (1)
- 4- Board Diversity (4)
- 5- CEO / Chairman Separation (1)
- 6- Board Meetings (2)
- 7- Disclosure of past/ present directorships (2)
- 8- Nominating Committee and Board Performance (4)

Audit Committee (4)

- 9- Audit Committee Meetings (2)
- 10- Audit Committee Composition (2)

Remuneration Matters (5)

- 11- Director and Executive Remuneration (5)

REIT Organization (11)

- 12- AGM (1)
- 13- Manager Independence, Provision for Removal (4)
- 14- Trustee: Trust Deed (4)
- 15- Governance Guidelines (2)

Fees (18)

- 16- Structure of Manager's Management Fees (3)
- 17- Acquisition/ Divestment Fees (5)
- 18- Disclosure of Fees (1)
- 19- Property Manager's Fees (4)
- 20- Payment of Fees in Units (3)
- 21- Manager's Management Fees- % Levels (2)

Related Party Transactions (13)

- 22- Disclosure (9)
- 23- Role of Trustee (2)
- 24- Independent Experts (2)

Gearing (5)

- 25- Disclosure: Rating, Look-Through (4)

Ownership (3)

- 26- Disclosure (1)
- 27- Concentration (2)

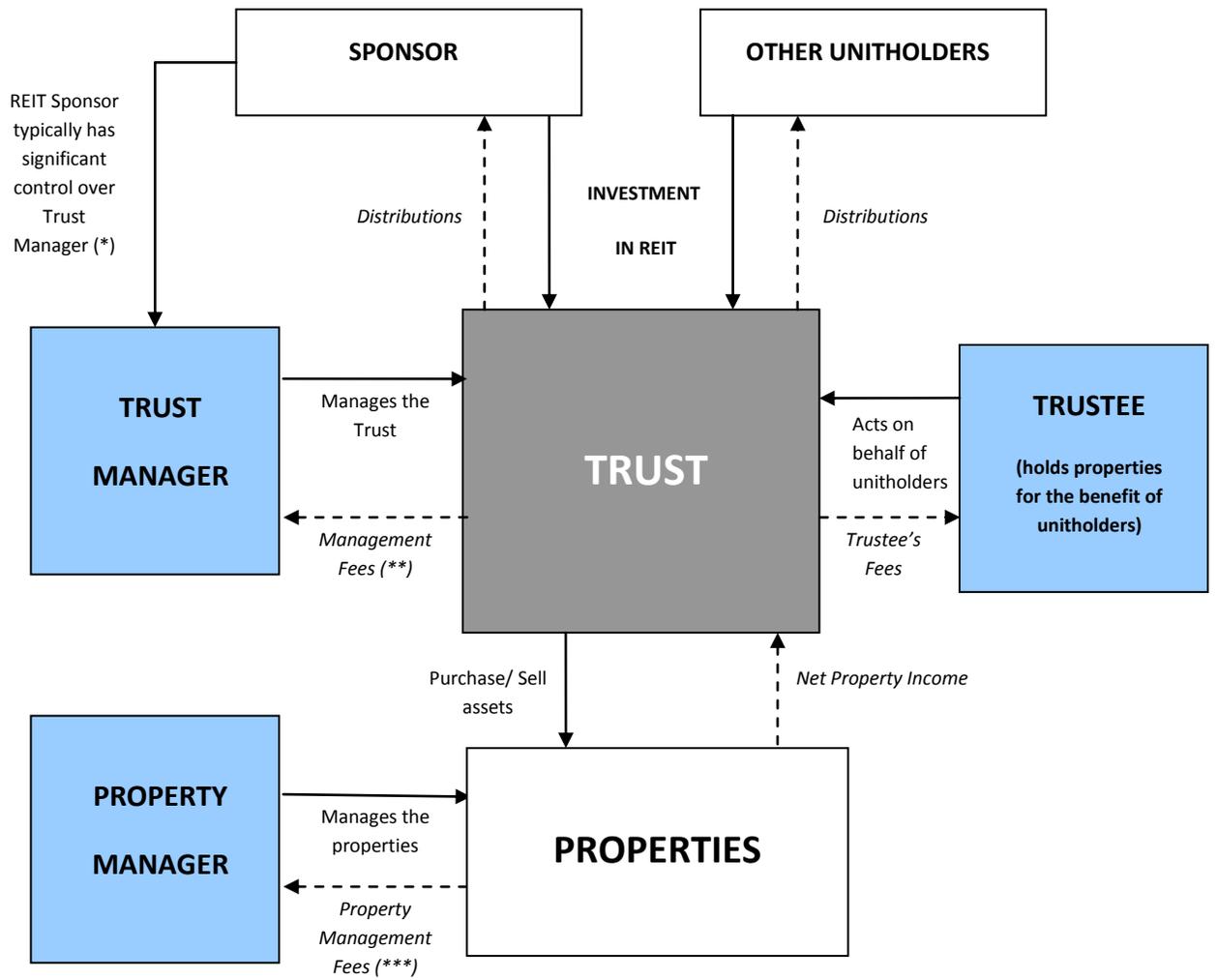
The R-index accommodates S-REIT's regulatory environment. REITs in Singapore are governed by the Code on Collective Investment Schemes (CIS Code) and the Property Fund Guidelines (Appendix 6 of the CIS Code). The CIS Code is non-statutory, i.e. a breach of the CIS Code does not of itself lead to legal sanction. However, failure to comply may be relied on in legal proceedings and a breach of the Code will be taken into account in determining whether to revoke or suspend the operation of the particular fund. In addition to the CIS Code, REITs are subjected to market authorities' requirements in terms of governance. The Monetary Authority of Singapore (MAS) issued its Code of Corporate Governance in 2005. Compliance with the Code is not mandatory but listed companies are required under the Singapore Exchange Listing Rules to disclose their corporate governance practices and give explanations for deviations from the Code in their annual reports. This "comply or explain" feature of Singapore's corporate governance regulations does in effect give a lot of leeway to S-REITs, and results in a range of practices that the R-Index has to capture.

The unique situation of Asian REITs pervades all 27 provisions included in the R-Index. Four categories in the R-Index are more specific to externally managed REITs: REIT Organization, Fees, Related Party Transactions, and Gearing.

REIT Organization

Figure 1 shows the classic structure of an externally managed Asian REIT. Although this generic model is shared by all sponsored S-REITs, there can be significant differences among REITs both in terms of origin and involvement of the various parties. For instance, the Trust Manager might be a subsidiary of the Sponsor, or an external manager with no links whatsoever with the other parties in the Trust. Similarly, the Property Manager might be related to the Sponsor, or in the case of external managers to the Trust Manager. Classically, the Trustee is rather passive. However, the Property Fund Guidelines mention several instances in which the Trustee should play a proactive role (e.g. Related Party Transactions). In such a setting, the entrenchment of the Trust Manager generates potentially significant agency issues. Conditions leading to the choice of manager as well as provisions for removal (including consequences of termination of management agreements) are essential points covered in the R-Index.

FIGURE 1. Externally Managed Asian REITs Generic Structure (with a Sponsor)



Source : JP Morgan (2009) and Lecomte et al. (2010)

(*) The Sponsor has a significant holding in the REIT.

(**) Management fees include base fee, performance fees and acquisition / divestment fees.

(***) Property management fees might include leasing commissions.

Fees

The Trust structure generates an array of fees from the Trust to the Manager, the Property Manager, and the Trustee. Manager's fees are the most important ones among these fees. In the externally managed framework, the REIT itself has no employees. The Manager performs all work on behalf of the Trust in exchange for fees. Manager's fees include a base fee, a performance fee and, in some cases, acquisition/ divestment fees. Base fees and performance fees (whose total amounts to the manager's management fees) can take many shapes, from a flat percentage of the Assets Under Management (AUM) to a percentage of net income conditional on a pre-determined benchmark, or any combination in-between. The structure and disclosure of all three categories of fees are key indicators of good corporate governance in the R-Index. In a principal-agent framework, the more fees are conditional on the Manager's actual performance, the better for unitholders. The situation is similar for the Property Manager's fees.

Acquisition and divestment fees paid to the Trust Manager are the subject of debate. Combined with management fees based on AUM, they might give the wrong incentives to managers and become enmeshed into the broader issues of related party transactions and gearing. As a result, the R-Index favors S-REITs which do not pay acquisition / divestment fees to their Managers. If such fees are paid, S-REITs are scored on their level of disclosure.

Finally, the R-Index focuses on the relative level of fees assessed by two operating metrics: manager's management fees as a percentage of deposited properties, and total manager's fees as a percentage of net property income.

Related Party Transactions

The Sponsor-satellite ownership model coupled with relatively narrow and illiquid commercial property markets puts a special emphasis on Related Party Transactions (RPTs) in the context of Asian REITs. This issue, although exacerbated in case of property transactions, is not specific to the listed property sector. The R-Index does not evaluate the materiality of RPTs on a quantitative standpoint but rather focuses on the disclosure and processes related to RPTs in order to qualify transparency as well as potential misalignment of interests between Sponsor, Manager and unitholders. The Singapore Code on Collective Investment Schemes (Appendix 6- Section 5: Interested-Party Transactions) requires property funds to make public their policies governing transactions subject to a system of checks and balances as well as a disclosure process whenever there is a risk of potential abuse. In addition to the scope of RPT (i.e. definition of related parties and relevant transactions), other issues are the influence given to non-controlling shareholders (i.e. Trustee) over the decision-making process, and the role of independent experts.

Gearing

The issue of gearing is not specific to Asian REITs as the Singapore Code on Collective Investment Schemes (Appendix 6- Section 9: Aggregate Leverage Limit) limits the amount of gearing to 35% of the fund's deposited property, or up to 60% if a credit rating from Fitch, Moody's or Standard and Poor's is maintained and disclosed to the Public. However, in the context of an externally managed Trust where Manager's fees are not linked to net income (i.e. net of borrowing costs), gearing can trigger agency costs. The R-Index scores the quality of REITs'

disclosure as well as the impact of leverage on the Trusts' income generating abilities (proxied by borrowing costs as a percentage of net property income).

3. Scorecard of the R-Index

Scores in the R-index are determined based on 75 core elements. Each element is worth one point, with some multiple choice elements being rated 1, 0.5, or 0. In addition to these core 75 elements, the index encompasses a "bonus and penalty" system to account for the "comply and explain" feature of corporate governance practices in Singapore: 13 bonus points and 11 penalties materialized as one positive or negative point each. Hence, there are 99 elements in the R-Index as shown in Table 3 below. The overall score is simply the sum of all the points (core plus bonuses minus penalties). The index range is therefore [-11; +88] with a median at 38.5. Annual scores and sub-scores are based on data collected in annual reports and other public sources. For each of the 8 corporate governance categories covered in the R-Index (i.e., Board Matters, Audit Committee, Remuneration Matters, REIT Organization, Fees, Related Party Transactions, Gearing, Ownership), the scorecard provides a sub-score. The higher the score and sub-scores, the better the corporate governance practices of the REIT. The index methodology aims to be objective and transparent. However, once relevant elements are selected, crucial (and subjective) choices for the macro-relevance of the index have to be made with respect to weighting. The index weights depend on the number of elements in each category. In its current version, the R-Index emphasizes Fees (24% of total score), Board Matters (19%), Related Party Transactions (16%), and REIT Organization (15%). These weights as well as the scorecard were established after an extensive consultation with institutional investors and experts in Asian REITs, all members of the Asia Pacific Real Estate Association (APREA). An extensive consultation process with Singapore REIT managers took place in 2010 and 2011 to get their feedback on the R-Index scorecard. Their remarks were incorporated into the current version of the scorecard presented in Appendix 1.

TABLE 3. R-Index: Elements in the 8 Corporate Governance Categories and Weights

CATEGORY	CORE	BONUSES	PENALTIES	MAXIMUM SCORE	MINIMUM SCORE	# ELEMENTS IN CATEGORY	% WEIGHTS IN TOTAL SCORE (*)
<i>BOARD</i>	16	2	1	18	-1	19	19%
<i>AUDIT</i>	4	1	1	5	-1	6	6%
<i>REMUNERATION</i>	5	2	1	7	-1	8	8%
<i>REIT ORGANIZATION</i>	11	3	1	14	-1	15	15%
<i>FEEES</i>	18	3	3	21	-3	24	25%
<i>RELATED PARTY TRANSACTIONS</i>	13	2	1	15	-1	16	16%
<i>GEARING</i>	5	0	1	5	-1	6	6%
<i>OWNERSHIP</i>	3	0	2	3	-2	5	5%
TOTAL	75	13	11	88	-11	99	100%

(*) after rounding

APPENDIX 1: The R-Index Scorecard

This index is relevant for externally managed REITs. Data collection is based on annual reports and other public information.

Criteria #	Description	SCORE
BOARD MATTERS		
1	<i>Board Composition</i>	
1.1	If the board comprises of at least 5 members but not more than 10	1
2	<i>Board Independence</i>	
2.1	If the proportion of independent directors on board is more than 50%	1
	between 1/3 and 50%	0.5
	less than 1/3	0
3	<i>Nominating and Remuneration Committee</i>	
3.1	If all members are independent	1
	If the majority is independent (including Chairman)	0.5
4	<i>Board Diversity</i>	
4.1	If the Board comprises of individuals with diverse qualifications and backgrounds	1
4.2	If the Board comprises of at least one individual with no real estate background	1
4.3	If the Board comprises of at least one individual with foreign qualification and background	1
4.4	If the Board comprises of at least one independent director with experience in the listed real estate industry (non Asian)	1
5	<i>CEO/ Chairman Separation</i>	
5.1	If the Chairman is an independent director	1
	If the Chairman is a non-executive director	0.5
	If the Chairman is the CEO, is related to the CEO, is a controlling shareholder or is an executive director	0
6	<i>Board Meetings</i>	
6.1	If the Board meets at least 6 times during the year	1
	If the Board meets at least once every quarter	0.5
	If the Board meets less than once every quarter	0
6.2	If attendance at Board meetings is reported	1
7	<i>Disclosure of past/ present directorships</i>	
7.1	If all present and past directorships of directors and senior management are disclosed	1
	If only present directorships are disclosed	0
7.2	If the nature of the directors' relationships with the company is fully disclosed (including affirmative disclosure of relationship or of absence of relationship)	1
8	<i>Nominating Committee and Board Performance</i>	
8.1	If the Board is assisted by a Nominating and Remuneration Committee (NRC)	1
8.2	If the Board Performance is formally assessed	1

8.3	If individual director appraisal is formally carried out	1
8.4	If the process of Board/ individual director performance appraisal is disclosed in detail	1
	<i>BONUSES (+)</i>	
	If at least one Board member is related to the Trustee	1
	If the concept of independent director is properly defined in AR	1
	<i>PENALTIES (-)</i>	
	If the proportion of Board members linked to Sponsor/ Manager is more than 50%	-1
	between 1/3 and 50%	-0.5
	less than 1/3	0
TOTAL SUB SCORE BOARD MATTERS		
AUDIT		
9	<i>Audit Committee Meetings</i>	
9.1	If the Audit Committee meets at least once every quarter	1
9.2	If attendance at Audit Committee meetings is reported	1
10	<i>Audit Committee Composition</i>	
10.1	If all members are independent directors	1
	If all are non executive directors with an independent chairman	0.5
	If one or more of the members are executive directors	0
10.2	If the chairman is a financial expert	1
	<i>BONUSES (+)</i>	
	If at least one Committee member is related to Trustee/ trustee related companies	1
	<i>PENALTIES (-)</i>	
	If at least one member is related to Sponsor / Manager	-1
TOTAL SUB SCORE AUDIT		
REMUNERATION MATTERS		
11	<i>Director and Executive remuneration</i>	
11.1	If adequate disclosure of executive directors' remuneration is provided to unit holders	1
11.2	If fees paid to non executive directors are disclosed in detail	1
11.3	If executive remuneration is, at least in part, performance-related (equity-linked compensation plans)	1
11.4	If remuneration bands and names of top five key executives are disclosed (smaller than S\$100,000 bands)	1
	If remuneration bands and names of top five key executives are disclosed (S\$100,000-S\$250,000 bands)	0.5
	If remuneration bands and names of top five key executives are disclosed (larger than S\$250,000 bands)	0

11.5	If the vesting period of stock options is over a period of 3 years	1
	<i>BONUSES (+)</i>	
	If exact remuneration of executive directors is disclosed (in currency units)	1
	If all board members linked to sponsor (except Chairman) do not receive directors' fees	1
	<i>PENALTIES (-)</i>	
	If a majority of members of the Nominating and Remuneration Committee are linked to sponsor/ manager	-1
TOTAL SUB SCORE REMUNERATION MATTERS		
REIT ORGANIZATION		
12	<i>AGM</i>	
12.1	If the REIT has held 1 AGM over FY	1
13	<i>Manager</i>	
13.1	If the manager is fully independent and not related to the sponsor	1
13.2	If rules pertaining to choice of manager are fully disclosed	1
13.3	If provisions for removal of manager are fully disclosed	1
13.4	If consequences of termination of management agreements (e.g. "poison pills") are fully disclosed	1
14	<i>Trustee</i>	
14.1	If Trust Deed is readily available to unitholders	1
14.2	If main provisions of Trust Deed are described in annual reports	1
14.3	If all transactions/links with trustee and trustee related companies are fully disclosed	1
14.4	If the Trustee made direct proposals to the Board over FY	1
15	<i>Governance guidelines</i>	
15.1	If corporate governance guidelines are fully disclosed	1
15.2	If corporate governance practices are properly referenced to Code of Corporate Governance 2005	1
	<i>BONUSES (+)</i>	
	If the REIT has a whistleblowing policy in place	1
	If key risks and methodology to cover them are disclosed in the annual report	1
	If there are rules limiting manager's ability to vote on management changes	1
	<i>PENALTIES (-)</i>	
	If Manager is related to Sponsor	-1
TOTAL SUB SCORE REIT ORGANIZATION		
FEES		
16	<i>Structure of Manager's Management Fees</i>	
16.1	If the basis for manager's performance fees is determined net of borrowing costs	1

16.2	If the basis for manager's performance fees is conditional on a benchmark	1
16.3	If manager's management fees include a component based on a Total Shareholder Return- type metric	1
17	<i>Acquisition / Divestment Fees</i>	
17.1	If acquisitions do not trigger fees paid to the Manager of the REIT	1
17.2	If divestments do not trigger fees paid to the Manager of the REIT	1
17.3	If in case of acquisition/disposals of properties, disclosure of fees is made in actual dollar quantum	1
17.4	If in case of acquisition, a profit forecast is made including expected incremental income to the REIT	1
17.5	If in case of disposal fees, value creation for unit holders is fully disclosed	1
18	<i>Disclosure of Fees</i>	
18.1	If fees paid to the Manager, the Property Manager and the Trustee are fully disclosed (including detailed amounts and underlying related party transactions)	1
19	<i>Property Manager's Fees</i>	
19.1	If property manager's fees are based on Net Property Income (and not gross revenue)	1
19.2	If property manager's fees include a performance related component (such as anchors, tenant mix, occupancy rates)	1
19.3	If property manager's fees are conditional on a benchmark	1
19.4	If property manager's fees are based on an incremental scale	1
20	<i>Payment of Fees in Units</i>	
20.1	If conditions for payment of manager's management fees in units are fully disclosed	1
20.2	If in case of acquisition fees, transaction date used for issuance and relevant unit price are reported for each acquisition	1
20.3	If dilution impact of payment of fees in units is fully disclosed	1
21	<i>Manager's Management Fees- Level (*)</i>	
21.1	<i>Manager's management fees as a % of Deposited Property</i>	
	If Manager's management fees are less than 0.6% of Assets under Management (Deposited Property)	1
	If Manager's management fees are equal to 0.6% of Assets under Management (Deposited Property)	0.5
	If Manager's management fees are greater than 0.6% of Assets under Management (Deposited Property)	0
21.2	<i>Total Manager's fees (including acquisition/ divestment fees) as a % of Net Property Income</i>	
	If Total Manager's fees are less than 10% of Net Property Income	1
	If Total Manager's fees are equal to 10% of Net Property Income	0.5
	If Total Manager's fees are greater than 10% of Net Property Income	0
	<i>BONUSES (+)</i>	
	If fees paid to the Manager, Property Manager and Trustee are fully disclosed in a Tabular form	1

If in case of acquisition fees, holding period for units received in payment is greater than 1 year	1
If payment of management fees in form of units is submitted to the Board or discussed in EGM	1
<i>PENALTIES (-)</i>	
If the Manager has applied for a waiver from local stock exchange's rules with respect to disclosure of fees (related party transactions)	-1
If total fees paid to Manager and Property Manager increased on a year/year basis, while Earnings per Unit decreased or remained equal	-1
If fees paid to property manager include leasing commissions	-1
TOTAL SUB SCORE FEES	
<i>(*) Thresholds defined after Ooi (2010) and industry consultations</i>	
RELATED PARTY TRANSACTIONS	
<i>22 Disclosure</i>	
22.1 If rules pertaining to related party transactions are fully disclosed	1
22.2 If all related party transactions are fully disclosed, including the provision of financial services (e.g. loans)	1
22.3 If adequate disclosures in AR include:	
i) identity of interested parties and their relationships with the REIT	1
ii) details of the assets to be acquired or sold, including a description of these assets and their location	1
iii) the prices at which these assets are to be acquired or sold	1
iv) the details of the valuations performed (including names of the valuers, methods used to value these assets and the dates of the valuations) and their assessed values	1
v) current/ expected rental yield	1
22.4 If transactions greater than 5% of the NAV are immediately announced and subject to unitholders' votes	1
22.5 If transactions greater than 5% of the NAV are reviewed by an independent expert whose opinion was made public to unitholders	1
<i>23 Role of Trustee</i>	
23.1 If one of the two valuers is commissioned independently by the Trustee	1
23.2 If the Trustee provides written confirmation for each related party transaction	1
If the Trustee only reviews the transaction but provides no written confirmation available to unitholders	0.5
<i>24 Independent Experts</i>	
24.1 If relationships of Independent Expert with the Manager or related parties are fully disclosed	1
24.2 If Independent Experts are explicitly selected according to legal standards	1
<i>BONUSES (+)</i>	
If the Trustee or Trustee related companies are defined as related parties	1

If transactions with parties related to Independent Non-Executive Directors are submitted to rules on related party transactions	1
<i>PENALTIES (-)</i>	
If the Audit Committee replaces unitholders in assessing related party transactions	-1
TOTAL SUBSCORE RELATED PARTY TRANSACTIONS	
GEARING	
25 <i>Disclosure</i>	
25.1 If gearing related information is fully disclosed (e.g. debt maturity profile, hedging interest rate risk, loan covenants)	1
25.2 If the REIT has voluntarily applied for a rating	1
25.3 If adequate information is provided about the optimal sources/ uses of funds	1
25.3 If unit holders are consulted about gearing decisions (e.g. EGM)	1
25.4 If "look through" gearing is reported	
<i>PENALTIES (-)</i>	
If Borrowing Costs are greater than 50% of Net Property Income	-1
TOTAL SUBSCORE GEARING	
OWNERSHIP	
26 <i>Disclosure</i>	
26.1 If the top 20 unitholders are disclosed in the annual report	1
27 <i>Concentration</i>	
27.1 If total concentration of share-ownership in the top 20 unitholders is less than 50%	1
27.2 if total concentration of share-ownership in the top 5 unitholders is less than 40%	1
<i>PENALTIES (-)</i>	
If the manager has a strategic shareholding in the REIT (entrenchment)	-1
If shareholders related to the Sponsor/ Manager have a blocking stake in the event of takeover	-1
TOTAL SUBSCORE OWNERSHIP	
TOTAL SCORE	



APREA is a non-profit industry association that represents and promotes real estate as an asset class in Asia Pacific through the provision of better information to investors, improving the general operating environment, encouraging best practices and unifying and strengthening the industry. It covers the four quadrants.

Its membership comprises developers and real estate operating companies, listed real estate trusts, unlisted property funds, investment managers, financial institutions, property securities fund managers, pension funds, sovereign wealth funds and other institutional investors, real estate consultants, corporate advisors, stockbrokers, investment advisors and universities.

The APREA Institute, APREA's education and training arm, provides the foundation for raising standards in the industry through the provision of practical and applied training programs. Its Certificate of Real Estate Investment Finance program is the only course of its kind in the region to be both developed and delivered by industry practitioners.

Contact

Please direct all enquiries regarding this research report to:

Mr. Noel Neo

Research Manager

Asia Pacific Real Estate Association Limited

58 Tras Street #02-01

Singapore 078997

Phone: +65 6438 1110

E-mail: noel.neo@aprea.asia

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