

# Northern Trust Global Securities Lending

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Prepared for: Surrey County  
Council Pension Fund

PRIVATE AND CONFIDENTIAL

# Northern Trust Securities Lending Programme

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# WHY NORTHERN TRUST?

- ✓ Our foundation of strength and stability helps clients grow with confidence
- ✓ Deep belief in our enduring principles of service, expertise and integrity, and the recognition that we're more than a financial institution

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## SUPERIOR CREDIT RATING

AA-

Standard & Poor's assigned the highest credit ratings of any comparable U.S.-based bank to our Corporation and main bank subsidiary, The Northern Trust Company.

AA

S&P

Fitch

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## WHY THIS IS IMPORTANT

- ✓ A strong capital position helps Northern Trust take advantage of profitable investment opportunities and withstand unforeseen adverse developments
- ✓ A single global platform means our technology spend is focused on developing our capabilities rather than integrating, reconciling or maintaining multiple systems or data points



# NORTHERN TRUST CAPITAL MARKETS

A significant global business with specialist teams of dedicated capital markets employees

**350+**

EMPLOYEES

**9**

SERVICING LOCATIONS

CHICAGO / HONG KONG / LONDON /  
NEW YORK / SEOUL / SINGAPORE /  
SYDNEY / TORONTO / DUBLIN

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## OUR EXPERTS WILL:

Take time to **listen** to understand your challenges

**Speak** the same language as your front office teams

Be **knowledgeable** of our entire suite of capabilities

**Build** client specific solutions that match your needs

Source: Northern Trust<sup>1</sup> as of 31<sup>st</sup> March 2021. Updated on an annual basis.

# NORTHERN TRUST'S SECURITIES LENDING PROGRAMME

Northern Trust has been a global industry leader in securities lending for almost 40 years. Our size, scale and technological innovation generates material value for our clients

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**1.5** trillion  
lendable assets

**193** billion  
on loan with  
**12.38%**  
utilisation

**466**  
participating  
clients from **31**  
countries

**73** approved  
universal banks  
and broker  
dealers

**35** lending  
markets including  
CSD's

**Aa2 / AA- /  
AA** top tier  
credit ratings

✓ **\$202 billion** of collateral held;  
\$58 billion (29%) cash collateral and \$143 billion (71%) non-cash collateral

✓ A **single global platform**, with an integrated forecast engine to enhance returns and a robust **risk management** with independent risk committees

✓ **Top Ten** Parent Borrowers (by loan volume):

BNP Paribas	Royal Bank of Canada
Citigroup	Bank of Nova Scotia
Bank of America	Goldman Sachs
Societe Generale	Toronto-Dominion Bank
J.P. Morgan Chase	Barclays Plc

All figures in USD as at 31/12/2021

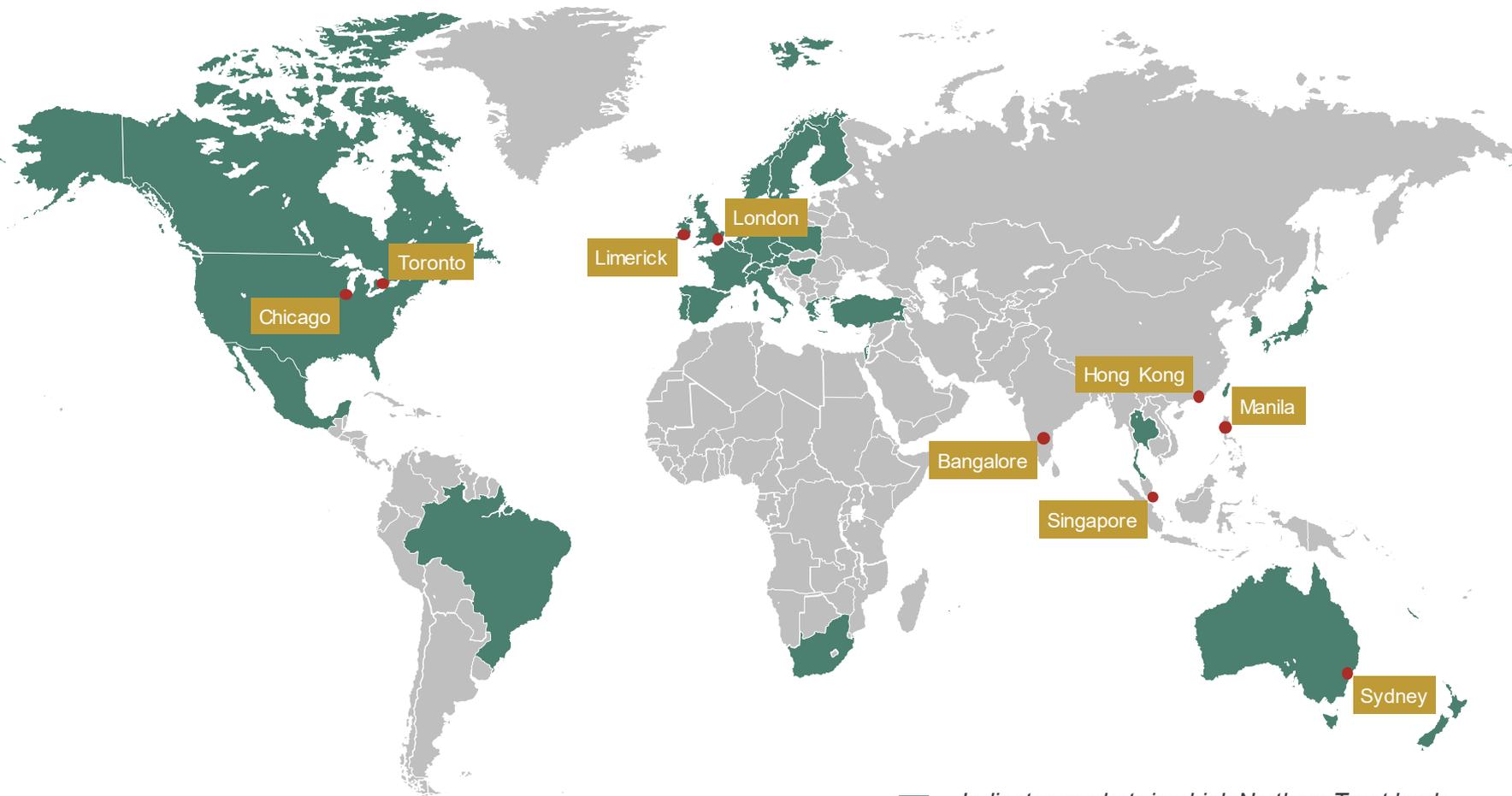




# NORTHERN TRUST'S SECURITIES LENDING PROGRAMME

Northern Trust lends in 35 countries with a local presence in nine locations and over 200 partners

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-  Indicates markets in which Northern Trust lends
-  Trading, servicing or operational locations

# GLOBAL PARTICIPATION AND COVERAGE

*Northern Trust lends in 35 countries:*

- 
- Australia
  - Austria
  - Belgium
  - Brazil
  - Canada
  - Czech Republic
  - Denmark
  - Eurobonds
  - Finland
  - France
  - Germany
  - Greece
  - Hong Kong
  - Hungary
  - Ireland
  - Israel
  - Italy
  - Japan
  - Korea
  - Mexico
  - Netherlands
  - New Zealand
  - Norway
  - Poland
  - Portugal
  - Singapore
  - South Africa
  - Spain
  - Sweden
  - Switzerland
  - Taiwan
  - Thailand
  - Turkey
  - UK
  - US

## **Client Servicing Locations: 4 Cities**

- Chicago
- London
- Singapore
- Sydney

## **Trading Locations: 5 Cities**

- Chicago
- London
- Toronto
- Hong Kong
- Sydney

## **Operational Locations: 6 Cities**

- Chicago
- London
- Hong Kong
- Bangalore
- Manila
- Limerick



# NORTHERN TRUST VALUE PROPOSITION

*Northern Trust offers a unique and compelling proposition with four core elements.*

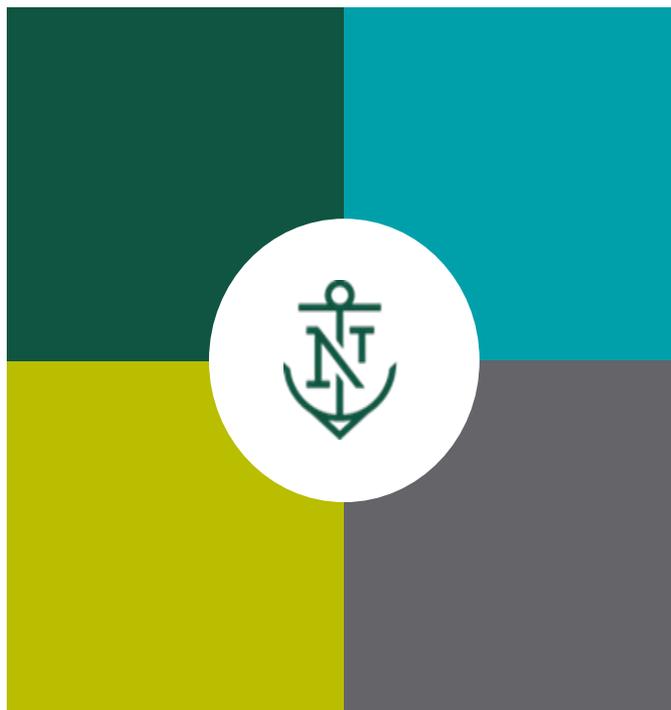
## A CORE BUSINESS

- One of the world's largest agent lenders, global custodians and investment managers
- Among the first global custodians to lend securities in 1981
- Extensive credit review practice and senior management oversight

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## INDUSTRY LEADERSHIP AND FINANCIAL STRENGTH

- Continuous outperformance of industry benchmarks (e.g. IHS Markit, FIS and DataLend)
- Executive members of the major industry associations
- Exceptional financial strength – one of only five U.S. based banks to carry an issuer credit rating from S&P of “AA-”
- Strong Tier 1 Capital Ratio of 13% as at March 31, 2021



## A GLOBALLY INTEGRATED, HIGH-PERFORMANCE TEAM

- Dedicated client servicing support
- Single, global proprietary securities lending platform
- Single global team of professionals focused on optimising risk adjusted revenue potential for clients with a robust and consistent investment process

## A CONSULTATIVE APPROACH TO DEVELOPING INNOVATIVE SOLUTIONS

- A culture focused on listening to, and understanding, our clients risk and return objectives
- We review opportunities, anticipate clients' needs and deliver customised solutions where required
- Our transparent web-based system, Northern Trust Passport ©, provides real time reporting

# TECHNOLOGY FOCUS AND ADVANTAGE

## Global Securities Lending (GSL)

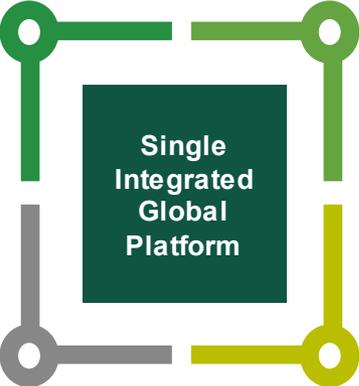
- GSL is our Proprietary trading system
- It allows us to bring new system enhancements to market more quickly
- Our single integrated global platform strategy enables us to optimally connect our clients' supply with borrower demand around the world at all times

## Next Generation Trading (NGT)

- A leader in the use of Equilend's 'Next Generation Trading' capability
- Inventory is targeted and customised to borrowers based on client parameters
- Expanded straight through processing capabilities allows greater focus on high intrinsic value trading
- Automates the majority of loans (90%)

## Machine Learning / AI

- The development of an innovative pricing engine that utilises machine learning and AI to more effectively forecast securities lending loan rates
- Capture wider spreads and help enhance performance
- Key component to drive greater autonomy in execution



Single  
Integrated  
Global  
Platform

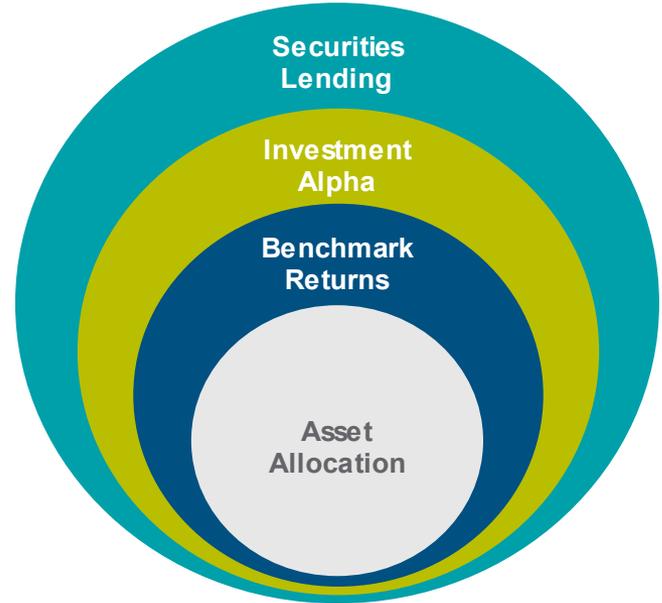
### Technology

- *Our firm wide technology spending is focused on developing our capabilities rather than integrating, reconciling or maintaining multiple systems or data points*
- *Our technology experts add value to our clients by increasing efficiency, accuracy and flexibility*

# Securities Lending Explained

# WHAT IS SECURITIES LENDING

- A **temporary** loan of securities against **collateral** with margin for a **fee**
- Absolute transfer of title of loaned securities and collateral
- Securities and collateral released **simultaneously**, or collateral received upfront
- **Seamless** to clients' investment strategies, decisions and activities
- Lender may **recall** securities at any time, with shares returned within standard market settlement cycle or before
- Borrower may return securities any time
- Borrower obligated to 'manufacture' **economic benefits** to lender
- Lender loses the right to **vote** unless securities are recalled



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## Parties to a loan

Lender	The beneficial owner of the securities
Lending agent (Northern Trust)	The party negotiating and facilitating the loan
Borrower	To counterparty to whom the assets are being lent (usually a large financial institution)
Re-investment manager	The party investing the cash collateral





# SECURITIES LENDING PROMOTES EFFICIENCY AND LIQUIDITY IN FINANCIAL MARKETS



## PROMOTES MARKET AND LIQUIDITY

- Allows price discovery and the arbitrage of pricing inefficiencies
- Supports the development of the capital markets by facilitating various investment strategies
- Important part of risk and liquidity management
- Integral component of developed securities market for investors



## WHO LENDS SECURITIES?

- Long-term, institutional investors of assets lend securities within their portfolio strategy
- Asset owners
- Asset managers



## WHY LEND SECURITIES?

- Enhance portfolio returns
- Offset or eliminate costs of custody
- Benefit from well-managed risks



## WHO BORROWS SECURITIES?

- Investment banks
- Prime brokers
- Local brokers
- Other intermediaries
- Investment funds
- Prop traders
- Market makers



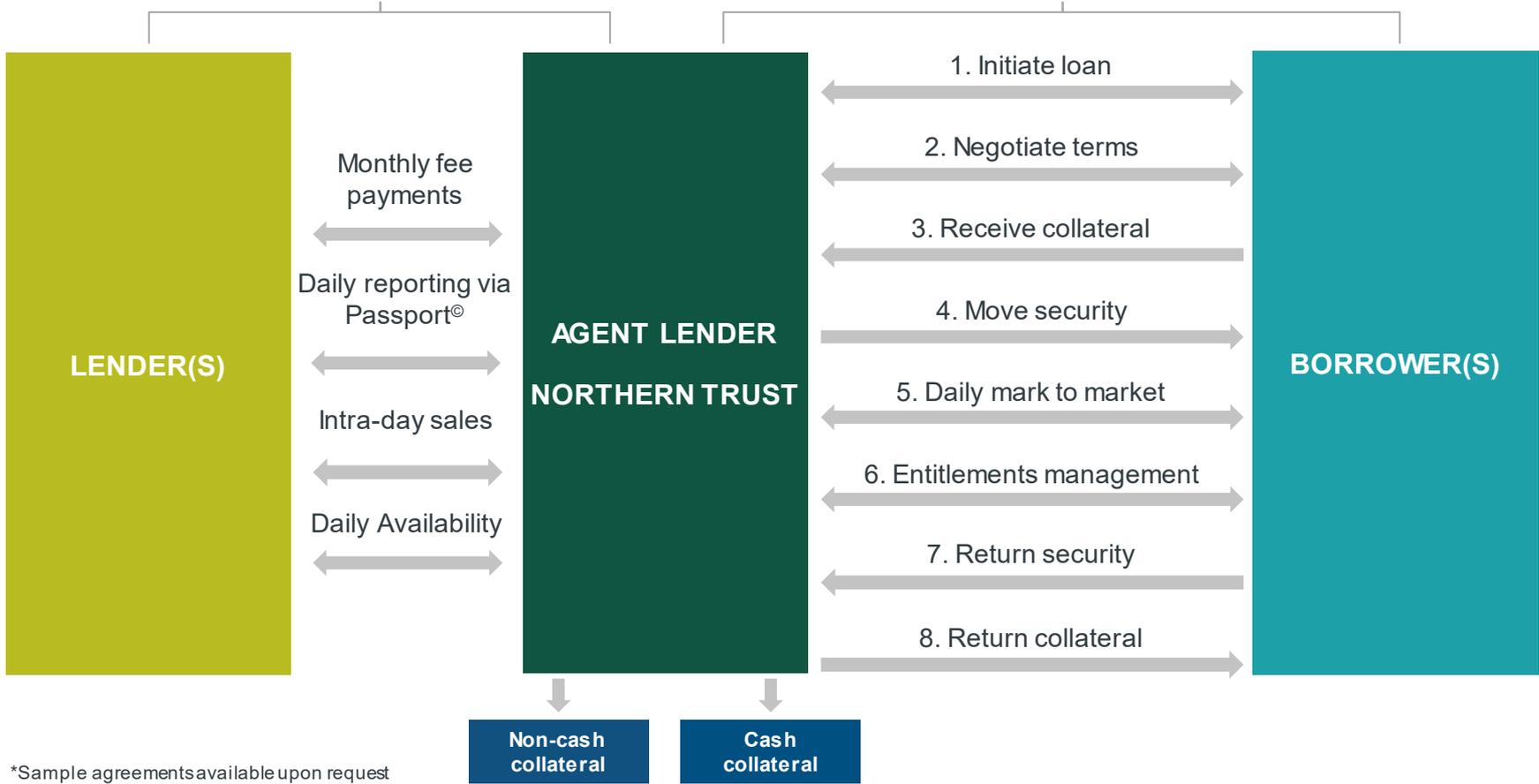
## WHY BORROW SECURITIES?

- Hedging
- Directional trading
- Arbitrage strategies
- Fulfilling settlement obligations
- Financing trades

# THE LIFECYCLE OF A LOAN

## Securities Lending Authorisation Agreement (SLAA\*)

## Master Borrowing Agreement (e.g. GMSLA 2010\*)



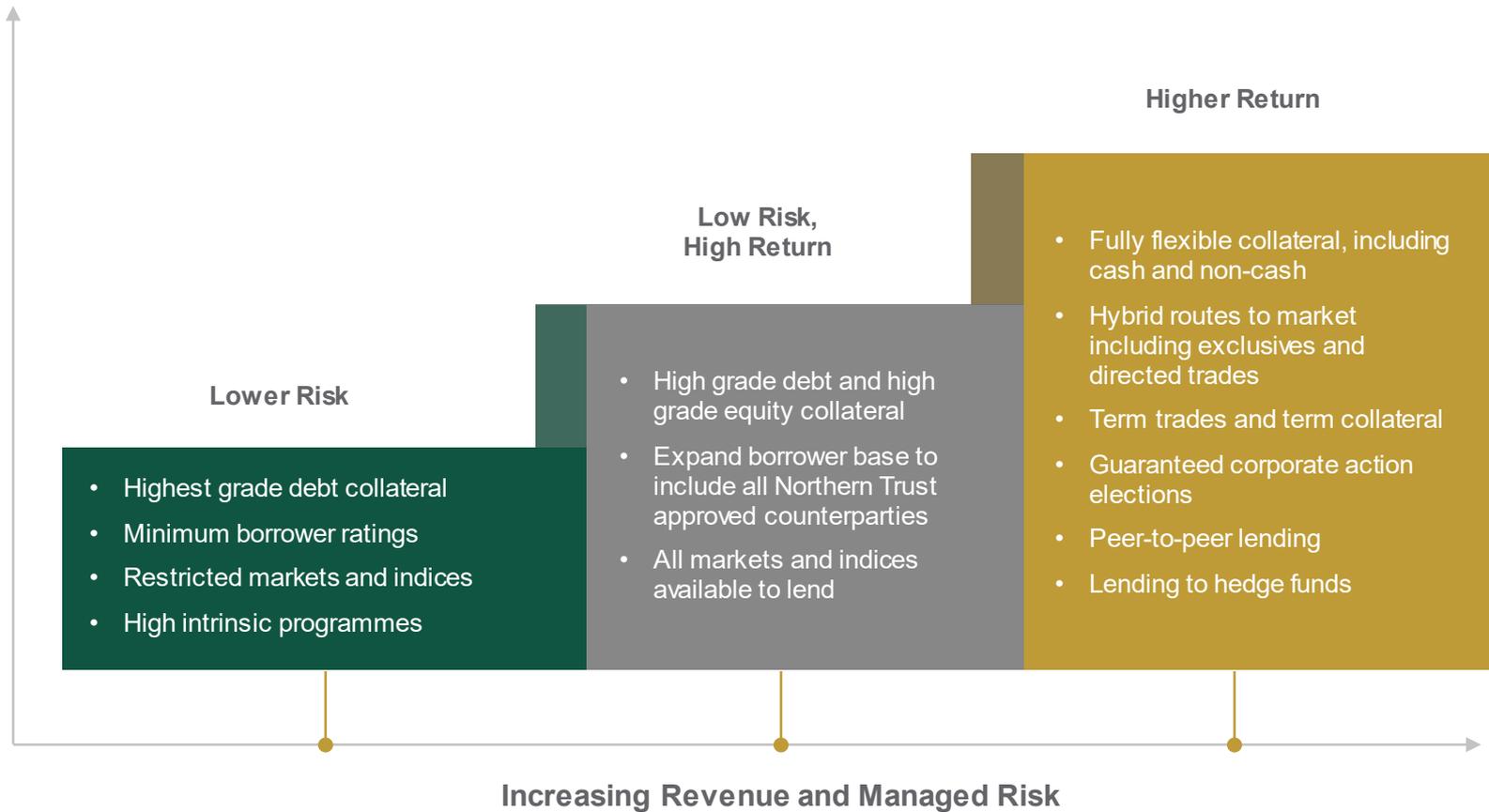
\*Sample agreements available upon request



# PROGRAMME CUSTOMISATION

A bespoke lending programme allows returns to grow over time, within a risk-managed environment

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# HOW REVENUE IS GENERATED: NON-CASH COLLATERAL LOAN

Example: Northern Trust lends \$25 million of US Treasuries at par

## Non-Cash Loan:

The \$25 million market value loan is for 30 days collateralised by a US Treasury.

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<b>1</b>	Receive non-cash collateral valued at <b>\$25,500,000</b> (102%)	
<b>2</b>	Fee charged to borrower on the value of the loan (10 bps)	\$ 2,083.33
<b>3</b>	Gross revenue (gross spread 10 bps) credited to client monthly	\$ 2,083.33
<b>4</b>	Monthly lender's fee (@ 30%)	<u>\$ 625.00</u>
<b>5</b>	<b>Net client earnings</b>	<b>\$ 1,458.34</b>

# Securities Lending Trading and Collateral Management

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# UNIQUE TRADING FOCUS

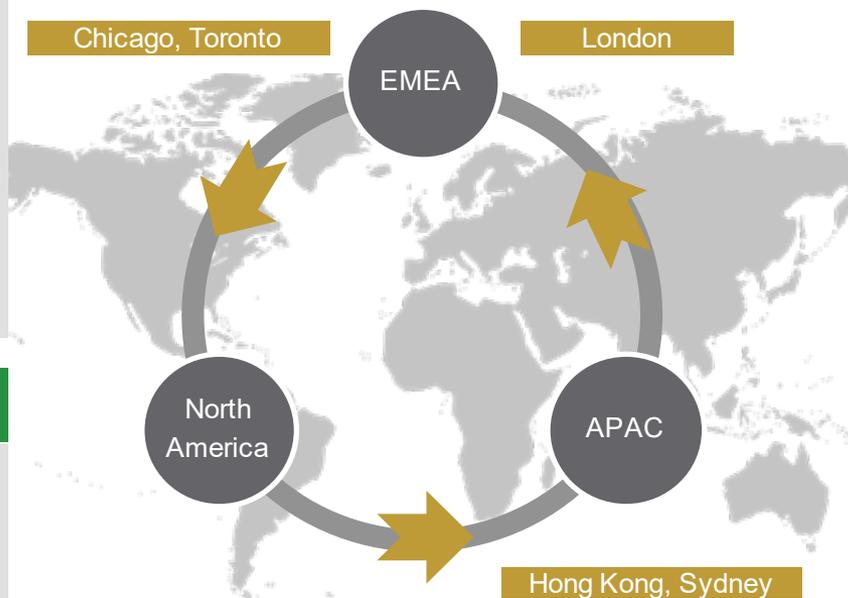
Our 'pass-the-book' operating model enables us to continuously serve our clients around the clock

## Trading Strategies

- Straight through processing on trades
- Daily Average Trading Volume (DATV) trading solutions to minimise fails
- Superior trade execution of optional scrip securities

## Global Presence & Experience

- Our securities lending programme has been running for over 35 years
- We operate as one global team, with an average of 16 years of trading experience and 20 years of management experience



## Client Focus

- We aim to optimise client revenue while keeping within our clients' risk parameters
- Ability to develop bespoke programmes for clients
- New opportunities to enhance revenue

## Proprietary System

- Our single global trading system connects traders in Sydney, Hong Kong, London, Chicago, and Toronto
- We continue to invest in technology



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# SECURITIES LENDING TRADING STRATEGY

*Objective: To maximise portfolio returns through superior trading whilst managing risks*

## Maximise Portfolio Returns

- Maximise revenue across a portfolio in accordance with the beneficial owner's risk parameter settings
- Analyse and consider the optimum mix of available trade structures within any particular jurisdiction
- Demonstrate to clients where existing parameters are preventing the realisation of enhanced returns

## Superior Trading Performance

- Understand demand trends to deploy effective strategies to achieve outperformance
- Utilise industry data in internal variance reports to actively track our performance trends
- Coordinated lending and reinvestment approach

## Manage Risks

- Maintain robust risk management policies that work in conjunction with our first two objectives
- In-built system flexibility to allow our clients to customise their own risk parameters
- Proactively generate solutions so that the underlying risk profile is not compromised

# ROUTES TO MARKET

	Open Programme	Exclusive Arrangements	High Intrinsic Stock Lending	Other Considerations
	<ul style="list-style-type: none"> <li>Securities lent and priced based on level of borrower demand</li> <li>Loans made to an array of client-approved borrowers</li> <li>Collateral can be a mixture of cash and non-cash based on client requirements</li> <li>Loans are not specific to any one borrower and are allocated to clients based on a 'queuing' algorithm</li> </ul>	<ul style="list-style-type: none"> <li>Provide potential for enhanced revenue</li> <li>A single borrower gains 'exclusive' access to portfolio for specified time</li> <li>Fee is paid for exclusive access based on the market value available to lend, regardless of how much is borrowed</li> <li>Independent of any other lending activity</li> <li>Terms governed by an addendum to the borrower agreement</li> <li>Can be renegotiated if there is a material change to the portfolio</li> <li>Arrangements allow for early termination by either party</li> </ul>	<ul style="list-style-type: none"> <li>Fully-customised solution to lend a single holding or handful of holdings, often strategic in nature to borrower(s) where intrinsic value is extremely high</li> <li>Loan(s) segregated from custom or exclusive lending program to provide full customisation</li> <li>Acceptable collateral and margins based on the client's requirements</li> <li>Single stock trading revenue in dollar terms or basis points known upfront before trading</li> <li>Unlike an exclusive arrangement – does not have a fixed period and can be lent to more than one borrower</li> </ul>	<ul style="list-style-type: none"> <li>Factors to be considered include diversification, turnover, size, tax rate, collateral, 'special' activity and demand</li> <li>Consideration of those helps determine whether revenue maximisation is carried out through custom, exclusive, or single stock lending</li> <li>As demand factors change over time, it is ideal to be able to move between structures to optimise returns</li> <li>Exclusives and single stock trading are often sought-after because of the guaranteed income flow but should be carefully timed with other market offerings</li> </ul>
	<ul style="list-style-type: none"> <li>Operates on a pooled / consolidated basis with multiple "participating lenders" in the programme. Not feasible if clients want complete segregation</li> <li>No clients are currently operating in our programme on a one-for-one basis per transaction in the open book. A standard SLAA is required for this route to market</li> </ul>	<ul style="list-style-type: none"> <li>Clients who have exceptional bespoke requirements with an attractive portfolio of "special / hot stocks" may be able to generate incremental return through an exclusive (one lender to one borrower per loan) arrangement. A standard SLAA is required for this route to market</li> </ul>	<ul style="list-style-type: none"> <li>Similar to an exclusive arrangement – but a client or borrower is not committing to specific stocks for any period of time. The revenue is paid while stocks remain "special" with high intrinsic value</li> </ul>	
	<ul style="list-style-type: none"> <li>Route provides the most consistent and maximum returns given portfolio mix</li> <li>However it requires amalgamating other client assets when making loans</li> </ul>	<ul style="list-style-type: none"> <li>Not necessarily viable for borrowers who do not want to commit to a fixed term on a handful of special stocks which may not be "special" for the duration of the term</li> </ul>	<ul style="list-style-type: none"> <li>May be feasible to all parties if a client's portfolio has a continuous stream of specials in their portfolio. Also allows client to segregate loan activity from other clients</li> <li>Revenue is earned on a stock by stock basis and would be highly variable depending on demand for the holdings</li> </ul>	



# OVERALL COLLATERAL MANAGEMENT

Northern Trust accepts both cash and non-cash collateral.

**Loans are initially collateralised according to market convention at 102%, 105% or 108%**

- All loans are marked to market daily
- Collateral maintenance margins may vary by collateral type or market events

**Variety of cash collateral options available:**

- Daily monitoring of portfolio reinvestment guidelines using Blackrock Solutions' Aladdin<sup>®</sup> software
- Stringent management of interest rate sensitivity

**Standard collateralisation:**

- Fixed income loan versus cash, fixed income or equity collateral
- Equity loans versus cash, fixed income or equity collateral



## Non-cash collateral

- Custom collateral options
- Bilateral and tri-party arrangements of high grade collateral may include:
  - OECD Government and Agency Securities
  - Equities
  - Supranationals
  - Corporate Bonds
  - ETFs



## Cash collateral

- Custom collateral options
- Multiple currencies
  - USD
  - EUR
  - GBP
  - AUD
  - JPY

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# COLLATERAL MANAGEMENT

*Loans and collateral are valued daily to determine proper collateralisation*

## New Loans

- Collateral is received simultaneously or prior to settlement of the loan.

Same currency collateralised at 102%\*

Cross currency and global equities collateralise at 105%\*

## Programme Parameters

- Security loans are limited to programme parameters including acceptable cash and noncash collateral, acceptable borrowers, acceptable markets and other restrictions.

\*Subject to de minimus rules

## Daily Monitoring

Collateral is monitored throughout the day based on new loan and mark to market activity.

Based on Borrower's collateralisation level:

- NT requests additional collateral to cover the shortfall, or
- Borrowers request excess collateral to be returned

Collateral is monitored for maturing noncash collateral

- Swap out collateral prior to maturity
- Replace collateral on maturity date

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# Managing Risk

# MANAGING RISK IN A SECURITIES LENDING PROGRAMME

*Risk management is the cornerstone of our securities lending programme*

## Cash & Non Cash Collateral

## Cash Only Collateral

### Borrower

### Trade Settlement

### Cash Reinvestment

### Interest Rate

Borrower default combined with insufficient collateral to buy-in replacement securities & compensate for accrued entitlements

Client sells loaned security and borrower fails to return in time to settle the trade

Cash collateral investment becomes impaired or decreases in value

Loan rebate rate exceeds earnings on cash collateral investments

#### Mitigating Factors

- Rigorous credit committee review for approval
- Daily marking of loans/collateral
- Risk analysis tools (MSCI Barra) to measure and calibrate exposure
- Borrower default and close-out simulation exercise carried out at least once every 2 years
- In house transition manager

#### Mitigating Factors

- Robust automated reallocations
- Trade settlement protection/ Contractual Settlement
- Buffer management process

#### Mitigating Factors

- Multiple risk committee reviews and robust oversight of cash pools and investments
- Dedicated team of Fixed Income Research analysts reviewing securities
- Daily automated monitoring of portfolio guidelines and compliance

#### Mitigating Factors

- Close daily communication between lending and cash management teams
- Shared risk between Northern Trust and client
- Weekly “gap analysis” and periodic stress testing of portfolio



# RISK MANAGEMENT OVERSIGHT

*Risk management begins at the business level supported by senior level independent groups*

## Securities Lending Risk Council

- Provides senior management business oversight. Responsible for risk, compliance and control governance activities.
- Also monitors loan allocation process, cash collateral NAV, interest rate risk and loan/collateral stress testing.

## Capital Markets Credit Committee

- Monitors the financial viability of borrowers
- Sets limits for Northern Trust's balance sheet and securities lending programme
- Approves limits for counterparty groups, counterparties and specific products



## Collateralised Product Risk Committee

- Approves all collateral types, margin levels, and credit risk factors. Reviews borrower exposures and risk profiles.
- Establishes loan/collateral product limits and undertakes periodic stress testing.

## Credit & Liquidity Risk Management Committee

### Securities Approval Group

- Approves cash investment credit issuers, counterparties, and instruments
- Provides guidance and oversight of investment risk associated with cash reinvestment activity

# NORTHERN TRUST INDEMNIFICATION OPTIONS

Operational Indemnity		Borrower Default Indemnity
<p>Northern Trust indemnifies clients for direct losses they sustain if we are unable to recover borrowed securities or distributions from a borrower as a result of:</p> <ul style="list-style-type: none"> <li>• Our failure to make a reasoned determination of the creditworthiness of a borrower before lending a security and during the term of the loan if the borrower becomes insolvent.</li> <li>• Our failure to:               <ul style="list-style-type: none"> <li>○ Demand adequate and appropriate collateral;</li> <li>○ Perfect a security interest or obtain equivalent rights in the collateral;</li> <li>○ Maintain control of the collateral;</li> <li>○ Make a reasoned determination of the quality and suitability of Collateral</li> </ul> </li> <li>• Northern Trust's failure to perform its duties and responsibilities under the SLAA.</li> </ul>	<p>In the event of a filing or an "Event of Default" as defined under the borrowing agreement, Northern Trust would credit the client's account with any distributions payable and transfer into the client's account replacement securities, or credit the client's account with a transfer of cash and/or non-cash collateral equivalent to the value of the loaned securities at the date of default, to the extent there is sufficient Collateral.</p> <p>Under this option, the <u>client</u> bears the risk if there is any Collateral Shortfall*.</p>	<p>Our borrower default indemnity provides clients with additional protection in a borrower default.</p> <p>Under this option, Northern Trust will credit the client's account with any distributions payable and transfer into the client's account replacement securities, or credit the client's account with a transfer of cash and/or non-cash collateral equivalent to the value of the loaned securities at the date of default even if there is a collateral shortfall.</p> <p>Under this option, <u>Northern Trust</u> bears the risk if there is any Collateral Shortfall*.</p>
<p><b>Clients are responsible for any losses resulting from cash collateral investments (if applicable)</b></p>		
<p style="writing-mode: vertical-rl; transform: rotate(180deg);"><b>Fee Split Implications</b></p>	<p style="text-align: center;"><b>A higher revenue split to the client</b></p>	<p style="text-align: center;"><b>A lower revenue split to the client because Northern Trust will bear additional capital charges to support this indemnity</b></p>

\* Collateral Shortfall is the insufficiency of Collateral, or its proceeds, to enable the purchasing of replacement securities in the event of a Borrower default



# BORROWER RISK MANAGEMENT – APPROVAL PROCESS

*Our borrower selections follow stringent approval procedures and financial viability standards*



## FINANCIAL RESPONSIBILITY AND COMPLIANCE

- Each borrower and parent borrower must provide audited financial statements
- Borrowers must be financially sound and in compliance with regulatory capital requirements
- We also focus on condition and creditworthiness of the borrower's parent organisation



## LIMIT SETTING PROCESS

- Established framework to set borrower credit limits to reduce concentration risk via three tests:
- Credit Exposure relative to the borrower's capital
- Size of our exposure to the borrower relative to their total borrowing and to Northern Trust's total lending programme



## PERFORMANCE

- Each borrower's operating and trading performance is reviewed on an on-going basis
- Each borrower's level and distribution of loans outstanding is continuously monitored
- Automated systems allow in-depth monitoring of credit exposure to each borrower to ensure that credit exposures are maintained within limits



## RATINGS

- Independent public debt ratings are available on all of our parent borrowers
- Vast majority of parent borrowers have long-term credit ratings of A or better and short-term ratings of A-1 or better from at least one NRSRO

# BORROWER RISK MANAGEMENT : ON-GOING MONITORING

*Our credit analysts conduct on-going, regular reviews of our counterparties*

## CAPITAL MARKETS CREDIT COMMITTEE (CMCC)

- Monitors counterparty exposures derived from internal risk-based approach
- Supplements traditional credit analysis by providing insight into risk from borrowers' securities lending activity
- while maintaining a responsive capability to take actions as needed

### Daily review

- Credit analysts review market commentary and data to analyse financial stability
- Provides oversight while maintaining a responsive capability to take actions as needed

### Weekly review

- Review of key market indicators for certain counterparties (as available) based on proprietary internal tools

### Annual review

- Wide-scale analysis includes review of financial statements, capital calculations, rating agency analysis
- Presents comprehensive analysis on counterparty and credit limits to the CMCC



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NTGS SE: REGISTERED IN LUXEMBOURG UNDER NUMBER B232281. REGISTERED OFFICE: 10, RUE DU CHÂTEAU D'EAU, L-3364 LEUDELANGE, GRAND-DUCHY OF LUXEMBOURG. NORTHERN TRUST GLOBAL SERVICES SE IS AN AUTHORISED CREDIT INSTITUTION IN LUXEMBOURG UNDER CHAPTER 1 OF PART 1 OF THE LUXEMBOURG LAW OF 5 APRIL 1993 ON THE FINANCIAL SECTOR. IT IS AUTHORISED BY THE EUROPEAN CENTRAL BANK ("ECB") AND SUBJECT TO THE PRUDENTIAL SUPERVISION OF THE ECB AND THE LUXEMBOURG COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER ("CSSF").

NTGS SE, UK BRANCH: UK OFFICE IS AT 50 BANK STREET, CANARY WHARF, LONDON E14 5NT. AUTHORISED AND REGULATED BY THE EUROPEAN CENTRAL BANK AND LUXEMBOURG COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER. AUTHORISED BY THE PRUDENTIAL REGULATION AUTHORITY AND WITH DEEMED VARIATION OF PERMISSION. SUBJECT TO REGULATION BY THE FINANCIAL CONDUCT AUTHORITY AND LIMITED REGULATION BY THE PRUDENTIAL REGULATION AUTHORITY. THE NATURE AND EXTENT OF CONSUMER PROTECTIONS MAY DIFFER FROM THOSE FOR FIRMS BASED IN THE UK. DETAILS OF THE TEMPORARY PERMISSIONS REGIME, WHICH ALLOWS EEA-BASED FIRMS TO OPERATE IN THE UK FOR A LIMITED PERIOD WHILE SEEKING FULL AUTHORISATION, ARE AVAILABLE ON THE FINANCIAL CONDUCT AUTHORITY'S WEBSITE.



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