



International Swaps and Derivatives Association, Inc.

## **Disclosure Annex for Equity Derivative Transactions**

This Annex supplements and should be read in conjunction with the General Disclosure Statement. NOTHING IN THIS ANNEX AMENDS OR SUPERSEDES THE EXPRESS TERMS OF ANY TRANSACTION BETWEEN YOU AND US OR ANY RELATED GOVERNING DOCUMENTATION. Accordingly, descriptions in this Annex of the operation of Equity Transactions (as defined below) and the consequences of various events are in all cases subject to the actual terms of an Equity Transaction executed between you and us and its governing documentation (whether or not such qualification is expressly stated).

We refer to Transactions in which the Underliers are corporate equity securities or baskets or indexes of equity securities as “**Equity Transactions**”. The terms of an Equity Transaction may incorporate standard definitions, master confirmations, transaction matrices and other market standard terms, which may in turn be amended or customized pursuant to the terms of the Equity Transaction and its governing documentation. Before entering into an Equity Transaction, you should obtain and review carefully any such materials incorporated by reference as their content could materially affect your rights and obligations under the Equity Transaction, its value and its appropriateness for your particular objectives.

### **Valuation of Underliers**

Trading of equity securities typically takes place on securities exchanges, dealer quotation systems, electronic communications networks, and other trading facilities and execution venues, the regulation of which may differ from jurisdiction to jurisdiction. Futures and option contracts related to equity securities and indexes may trade on futures exchanges, securities exchanges or other derivatives exchanges, depending on the type of contract. The same equity security may trade in multiple venues and in different forms, such as depository receipts.

The terms of your Equity Transaction will specify the method of determining prices relevant to the computation of payments and deliveries and, if applicable, the satisfaction of exercise and other conditions, such as “knock-in” or “knock-out” events. Such methods may specify a time and an exchange or other venue in which prices are to be observed. Prices, which may be observable throughout the trading day, may change rapidly. As a result, your return on an Equity Transaction may be particularly sensitive to the choice of valuation times and valuation methods.

You should be aware that the price discovery mechanism on exchanges or other venues may not be uniform throughout the trading day, which may affect the valuation of an Equity Transaction. For example, exchanges may conduct auctions to set an opening or closing price, and trading characteristics and participants in after-hours trading sessions may differ from those during regular hour sessions.

Examples of valuation methods include:

- specifying an exchange or trading venue and a time of day at which the price is to be observed;
- use of an average price such as the arithmetic average of closing prices, or an intra-day average such as a volume-weighted average price, or a combination;
- use of the actual execution prices at which we or an affiliate are able to execute or unwind a hedge position in respect of an Equity Transaction;
- use of the official settlement price announced by an exchange for related listed derivatives contracts;
- a determination based on the price at which a hypothetical broker-dealer, subject to similar regulatory constraints as we or an affiliate, would be able to purchase or dispose of an amount of the Underlier corresponding to any hedge positions relating to an Equity Transaction; or
- use of an actual or estimated “risk bid” - i.e., the price at which we or another market participant would engage in a transaction as an at-risk principal to purchase or sell such amount of the Underlier.

The terms of an Equity Transaction may specify that any of the foregoing prices will be subject to deductions for fees, duties, taxes, costs or expenses. Such deductions may include fees that will be retained by us as an element of our profits on the Equity Transaction.

### **Other Factors Relevant to the Valuation of Equity Transactions**

Please refer to Section II.F – “The economic return of a Transaction may not be the same as the return from the Underlier” – and Section III.A – “Transactions are subject to market risk” – of the General Disclosure Statement regarding other factors that may be relevant to the valuation of an Equity Transaction.

### **Market Disruption Events**

The terms of an Equity Transaction may specify that certain events and conditions affecting an exchange or other venue relevant to an Equity Transaction, or related listed derivatives or other markets, will be treated as disruption events and their occurrence may result in postponement of a valuation date and/or changes in the method by which the price, level or value of an Underlier is determined for the relevant valuation date (such as using a price determined by the calculation agent if the disruption continues for a specified number of days or reducing the number of averaging dates used to determine an average price) and/or cancellation of the Equity Transaction. Subject to the terms of an Equity Transaction and the governing documentation, such events may include:

- the unscheduled or early closing of a market for an Underlier or related instruments (including closure due to technological failures or force majeure events affecting the relevant exchange) or the failure of a market for an Underlier or related instruments to open for trading as scheduled;
- suspension of or limitations on trading in an Underlier (or in some or all of its components in the case of an index or basket) or related instruments;
- other events that disrupt or impair the ability of market participants to execute

- transactions in an Underlier or related instruments;
- liquidity or trading volumes in an Underlier being insufficient; and
- conditions that affect the amount of time reasonably required for our or an affiliate's execution or unwinding of hedge positions, or the time that would be required for a hypothetical broker dealer to execute or unwind hedge positions.

The existence of such disruption events and their consequences may be subject to discretionary determinations by the calculation agent or other designated party, which may involve subjective judgment and uncertainty. The operation of such provisions may adversely affect the Transaction Economics.

## **Dividends**

An Equity Transaction may provide for payments or adjustments to be made in respect of dividends paid or announced by the issuer of an Underlier, such as an adjustment, for example, to a price cap or other economic term if a dividend is declared or paid otherwise than in accordance with a specified schedule of times and amounts. In such cases, the Equity Transaction typically will specify whether the payments or adjustments take effect upon the occurrence of a record date, ex-dividend date, dividend payment date or other date. The Equity Transaction may provide that if one of these triggering dates occurs but the actual dividend subsequently paid by the issuer differs from the declared dividend amount, then the party that received the corresponding payment may be obligated to return it, or the adjustment will be reversed, in some cases even after the term of the Equity Transaction has ended.

The Equity Transaction may specify that only a portion of an issuer's declared gross cash dividend will be taken into account in determining payments or adjustments. You should ensure that you understand the tax consequences under the laws of all relevant jurisdictions of dividend payments by an underlying issuer during the term of an Equity Transaction and consult tax and other advisors as you deem appropriate.

## **Adjustments for dilutive, concentrative and other issuer events**

Equity securities may be affected by events related to the issuer of such equity securities (“**issuer events**”) including: stock splits or consolidations, stock dividends and other distributions of securities, extraordinary dividends, spin-offs, capital calls, stock repurchases by the issuer or a subsidiary of the issuer, a distribution or separation of rights pursuant to certain takeover defense arrangements, mergers, reverse mergers, tender offers, partial tender offers, announcements of any of the foregoing, and other events with a dilutive or concentrative effect on the theoretical value of an Underlier or that affect the value of an Equity Transaction.

Subject to the terms of an Equity Transaction, the calculation agent may determine whether an event requires or permits an adjustment to be made and the terms and effective date of any adjustment. The terms of the Equity Transaction may afford the calculation agent more flexibility in making such determinations than would be the case, for example, under a traditional equity-linked security or under simple, mechanical methods of adjustment such as replacing the notional number of shares underlying an Equity Transaction with the amount of shares and other property that a holder of the Underlier would have received. The terms of an Equity Transaction may specify whether or not the calculation agent may make adjustments

to account solely for changes in volatility, expected dividends, stock loan rates or liquidity of an Underlier. Depending on the terms of the Equity Transaction, the calculation agent may or may not be obligated to follow any adjustments made by a derivatives exchange to related listed derivatives contracts. The calculation agent may be permitted to use its proprietary models in setting the terms of an adjustment, and it may be difficult for you to predict the resulting adjustments in advance. Verifying an adjustment's accuracy and its conformity to the terms of the Equity Transaction may require expertise in applying valuation models.

Depending on the terms of an Equity Transaction, there may be issuer events for which the calculation agent is not required to make adjustments. In such cases, the issuer event may adversely affect the Transaction Economics and there will be no compensating adjustments, notwithstanding that you had no opportunity to participate in benefits from the event that would have been available to a holder of the Underlier, such as an opportunity to sell into a partial tender offer or into the market at the prevailing price.

Certain methods of adjustment may be less favorable to you than other possible methods of adjustment, or no adjustment, and may adversely affect the Transaction Economics.

### **Changes to an Index**

Please see section III.O of the General Disclosure Statement – “Index Underliers” – for certain considerations relevant to Equity Transactions in which an Underlier is an index. For certain actions of the index sponsor, an Equity Transaction with an index Underlier may provide for adjustments similar to those described above or may treat the action as an extraordinary event, as described below.

### **Early Termination due to Extraordinary Events**

Equity Transactions may be subject to early termination upon the occurrence of certain events affecting the issuer or its shares, changes to an index, changes in law or regulation, or events that may affect markets for an Underlier or related instruments or our or an affiliate's ability to maintain or realize proceeds from hedge positions related to the Equity Transaction or the costs of doing so. Such events (“**extraordinary events**”) will be specified in the terms of an Equity Transaction and may include:

- Issuer events (as defined above);
- Nationalization of an issuer;
- Delisting of shares;
- Insolvency or a similar proceeding that results in legal prohibitions on the transfer of shares or a requirement to transfer shares to a trustee or similar official;
- Insolvency filing by or against an issuer, even if it does not have the consequences described immediately above;
- Modifications or cancellation of an equity index, or failure by the index sponsor to announce or calculate the index at the relevant times;
- Changes in law or regulation (and increased costs associated with such changes);
- Illiquidity in the market for an Underlier;
- Events that affect our or an affiliate's ability to maintain hedge positions related to the

Equity Transaction;

- Events that increase our costs associated with maintaining hedge positions related to the Equity Transaction or continuing to be a party to the Equity Transaction;
- Events that affect our ability to borrow shares at less than a specified cost or increase the cost of borrowing shares;
- Events that affect the transferability or convertibility of the foreign currency in which an Underlier or related hedge positions are denominated.

For events related to the merger of an issuer or a tender offer for its equity securities, the applicability of early termination may depend on the type of consideration offered to holders of the Underlier. For example, the terms of an Equity Transaction may provide that if the consideration consists of shares listed on same market as the predecessor shares and satisfies other conditions, then such successor shares may be substituted as Underliers, either with or without corresponding adjustments to other terms. Alternatively, the calculation agent may have discretion to make adjustments and/or terminate the Equity Transaction. For hedging or increased cost events, the hedging party or other designated party may have the ability to propose price adjustments to you and you may have the ability to choose between accepting the price adjustment (which may include the payment of increased costs) or termination of the Equity Transaction (which may result in an associated termination payment).

The terms of an Equity Transaction referencing exchange-traded funds (“ETFs”) or other collective investment vehicles may provide that specialized extraordinary events apply, including declines in net asset value, changes in or breaches of investment strategies, resignation of an investment manager or the departure of key persons.

Please see Section II.I of the General Disclosure Statement – “Termination of Transactions” – for certain considerations that may be relevant to the early termination of Equity Transactions due to the occurrence of extraordinary events.

### **Regulation of Underlying Markets**

Markets in equity securities are extensively regulated. Such regulation may include:

- reporting requirements relating to the acquisition of beneficial ownership of equity securities, changes in ownership, and arrangements that have the purpose or effect of changing or influencing control of an issuer;
- prohibitions on transacting on the basis of material non-public information and on manipulative trading;
- disgorgement of “short-swing” profits earned in connection with certain transactions (including Equity Transactions) in or related to an issuer’s shares by “insiders” or significant beneficial owners of the issuer;
- procedural, disclosure and substantive requirements with respect to distributions or repurchases of securities by or on behalf of an issuer or affiliate and the commencement of tender offers;
- limits on the size of positions that may be maintained in options or other instruments; and
- limitations on extending or obtaining credit for the purpose of purchasing or carrying equity securities.

You should consult with appropriate advisors regarding the applicability of such laws and regulations to an Equity Transaction. Unless otherwise agreed, we do not undertake to investigate or inform you of the legal ramifications of entering into an Equity Transaction.

### **Evolving Documentation Practices**

As of the publication date of this Disclosure Annex, documentation practices for Equity Transactions are evolving as a result of industry efforts to adopt a standardized definitional framework for a broad array of Equity Transactions and to facilitate greater use of automated trade processing. Accordingly, parties should monitor changing documentation practices and be especially alert to the possibility of documentation basis risk (i.e., the risk that Transactions that are intended to be economically similar may behave differently in certain circumstances due to their incorporation of different documentation terms). Please refer to Section III.H – “Transactions may involve legal and documentation risks” - of the General Disclosure Statement.

A related effort may result in the creation of an equity determinations committee to determine whether market disruption events have occurred with respect to certain Underliers. Determinations may be made without the consensus of market participants, and may not be binding on all Equity Transactions.

### **Additional Conflicts of Interest with respect to Issuers and Underliers**

We or our affiliates may, now or in the future, engage in business with one or more issuers of equity securities, their affiliates and their competitors, including making loans to or equity investments in one or more issuers, their affiliates and their competitors, participating in loan restructurings or recapitalizations with respect to them, or providing them with investment banking, asset management or other advisory services, including merger and acquisition or bankruptcy-related advisory services. These activities may present a conflict between our or our affiliates’ obligations and your interests as a party to an Equity Transaction. Please see Section IV.A. – “Our financial market activities may adversely impact Transactions” – of the General Disclosure Statement.

### **We may have information regarding an Underlier that you do not.**

We and our affiliates may, whether by virtue of the types of relationships described above or otherwise, at any time, be in possession of information in relation to an issuer or any of its affiliates that is or may be material in the context of an Equity Transaction and that may or may not be publicly available or known to a party to the Equity Transaction. Unless we expressly agree otherwise, the terms of an Equity Transaction do not create any obligation on our part to disclose to you any such relationship or information (whether or not confidential).

### **Public information with respect to issuers of Underliers may be inaccurate or incomplete**

Neither this risk disclosure statement nor any additional term sheet or disclosure statement is

intended to provide information with respect to any issuer, or any financial or other risks relating to the business or operations of any issuer in general or to any of the issuer's securities. You, as a party to an Equity Transaction, should make your own investigation into any issuer. We make no endorsement, representation or warranty regarding the accuracy or completeness of the information publicly disclosed by an issuer, whether contained in filings with the applicable securities regulator(s) or otherwise. Furthermore, we cannot give any assurance that all events occurring prior to the trade date of an Equity Transaction, including events that would affect the accuracy or completeness of the public filings of an underlying issuer or the value of the Underliers will have been publicly disclosed. Subsequent disclosure of any such events or the disclosure of or failure to disclose material future events concerning an issuer could adversely affect the Transaction Economics. You should undertake an independent investigation of each underlying issuer as in your and your advisors' judgment is appropriate to make an informed decision with respect to entering into an Equity Transaction.

### **Additional Considerations for Specific Product Types**

The following is a discussion of certain material risks, terms and characteristics of some common types of Equity Transactions. The categories employed below are illustrative only, and are intended to assist you in understanding key features of prospective Equity Transactions. The discussion should not be viewed as a comprehensive description of any particular Equity Transaction that may be under discussion between you and us. Because nomenclature is neither standardized nor sufficiently descriptive to capture all important transaction features and variations, a particular Equity Transaction may have additional or different risks, terms and characteristics than described below, even if it is referred to by one of the following category names.

#### **Equity Swaps**

An equity swap is an Equity Transaction that transfers the return attributable to a specified notional amount or number of shares of one or more Underliers from one party (the "equity amount payer") to the other (the "equity amount receiver"). The return is generally determined based on changes in the price or level of the Underlier between one or more valuation dates (or, in the case of the first valuation date, between the price or level observed as of that first valuation date and an agreed upon initial price, or in some cases an initial price that is set according to an agreed upon methodology following the trade date). Payments under this "equity leg" of the equity swap are made by the equity amount payer if the return is positive and by the equity amount receiver if the return is negative. Such payments may be due only once upon the termination of the equity swap (if there is only a single, final valuation date), or periodically during the term of the equity swap following each interim valuation date. In addition, an equity swap generally will comprise a "financing leg" under which the equity amount receiver will make periodic payments to the equity amount payer ("financing amount payments") calculated by multiplying the notional amount by a specified fixed or floating rate (which may be specified as the sum of a spread plus a benchmark rate, such as a LIBOR rate, that is reset periodically). If the equity swap is physically settled with respect to an Underlier or a component of an Underlier, then on the settlement date the equity amount payer will deliver a specified number of shares or other units of the Underlier or that component in exchange for a payment of the notional amount (or other specified amount) in respect of the Underlier or component.

Some of the important features which you should consider in reviewing the terms of a proposed equity swap include:

- *Dividends* -- The terms of the equity swap will specify whether or not payments in respect of dividends on the Underliers are included as part of the return paid to the equity amount receiver and how such payments are to be measured for purposes of the equity swap.
- *Notional amount* -- The notional amount may be specified as a monetary amount (e.g., a fixed dollar amount) or defined so that it corresponds to a fixed number of shares or units; it may or may not be reset on interim valuation dates. The notional amount may be in a different currency than the Underlier (in which case currency gains or losses associated with a direct long or short position in the Underlier will not be part of the return, although disruption events related to that currency may affect the Equity Transaction). Please refer to the FX Disclosure Annex for certain considerations related to foreign exchange market disruptions.
- *Financing leg* -- Please refer to the Disclosure Annex for Interest Rate Transactions, published by the International Swaps and Derivatives Association, Inc. for certain considerations relevant to the financing leg of an equity swap. You should note whether payment dates under the equity leg and the financing leg of a proposed equity swap coincide and consider the possibility that differences may arise due to business day conventions and disruption events. The interest rate paid or payable under the financing leg may differ from the rate at which either of the parties to the equity swap may fund itself.
- *Term and termination rights* --The equity swap may provide that one or both of the parties has an optional early termination right. Early termination will result in the designation of a final valuation date, which will be used to determine the final payment. The terms of the equity swap may specify that a break fee is payable upon early termination. In evaluating an equity swap in which your counterparty has an optional early termination right, you should assess the potential magnitude of termination payments and your ability to pay them at the appropriate time.
- *Economic return* -- Please refer to Section II.F of the General Disclosure Statement – “The economic return of a Transaction may not be the same as owning the Underlier”.

### **Equity Transactions with Depository Receipts as Underliers**

Some Equity Transactions may have depository receipts as Underliers or components of Underliers. Depository receipts are instruments issued by a depository institution and constituted under a deposit agreement that represent interests in the equity securities of an underlying issuer. Depository receipts may be listed on markets outside the jurisdiction of the underlying issuer and may trade and pay distributions in the currencies of other jurisdictions.

Before entering into an Equity Transaction with depository receipts as an Underlier or component, you should review and understand the terms describing how the transaction would be affected by an amendment or termination of the deposit agreement and how the adjustment and extraordinary event provisions will operate with respect to the depository, the underlying issuer, the depository receipts and the underlying shares.



## **Variance Swaps**

A variance swap typically is an Equity Transaction under which a “variance buyer” and a “variance seller” agree to exchange payments based on the difference between (A) an amount proportional to the observed variance (as defined under the terms of the variance swap) in the prices of an equity security or the levels of an equity index realized over a stated observation period and (B) a fixed amount that is agreed upon at execution. If this difference is positive, the variance buyer receives such amount from the variance seller, and if negative, the variance buyer pays its absolute value to the variance seller. If specified in the terms of the variance swap, the payment by the variance seller may be subject to an agreed upon cap. In the absence of a cap, the variance seller’s potential loss under a variance swap is not quantifiable and is potentially unlimited. Variance is not a measure of the rate of return on an Underlier. Variance differs from other measures, such as volatility, of the variability of the price or level of an Underlier.

A variance swap referencing an equity security or equity index will generally have the characteristics and risks described in Section II.J – “General characteristics of variance- and volatility-linked Transactions” – the General Disclosure Statement. In addition, for a variance swap on an equity security or equity index, it is important to understand whether an adjustment will be made for the payment of dividends. If no adjustment is made, dividend payments will tend to increase variance, and if an adjustment for dividends is made, the adjustment will tend to reduce variance.

In some cases, your objective in entering into a variance swap may be to hedge or offset other exposure you may have. There can be no assurance that prior observed relationships, if any, between realized variance and such other exposure will continue, or that payments under the variance swap will match such other exposure. See Section II.H – “No assurance of Transactions achieving your desired hedging objectives” – of the General Disclosure Statement.

## **Volatility Swaps**

A volatility swap is similar to a variance swap, except that payments under a volatility swap are determined by reference to the observed volatility (as defined under the terms of the volatility swap), rather than variance, in the prices of an equity security or the levels of an equity index realized over a stated observation period. Please refer to “Variance Swaps” above and Section II.J – “General characteristics of variance- and volatility-linked Transactions” – of the General Disclosure Statement.

In some cases, your objective in entering into a volatility swap may be to hedge or offset other exposure you may have. There can be no assurance that prior observed relationships, if any, between realized volatility and such other exposure will continue, or that payments under the volatility swap will match such other exposure. See Section II.H – “No assurance of Transactions achieving your desired hedging objectives” – of the General Disclosure Statement.

## **Variance Dispersion Swaps**

A variance dispersion swap is a combination of a variance swap on a basket or index (the “index variance swap”) and one or more variance swaps on specified components of that basket or index

(the “component variance swaps”). The party that is the variance seller under the index variance swap is the variance buyer under the component variance swaps, and vice versa. The payoff on the combined positions reflects the difference between (A) the variance of the basket or index relative to the applicable fixed amount set forth under the terms of the index variance swap and (B) the variance of the individual components relative to the applicable fixed amounts set forth under the terms of the component variance swaps. The party that is the variance seller under the index variance swap and the variance buyer under the component variance swaps (the “dispersion buyer”) will be owed a net payment by the other party (the “dispersion seller”) under the variance dispersion swap if the realized variance of the relevant components exceeds the applicable fixed amounts under the component variance swaps by more (or is less than the applicable fixed amounts by a smaller amount) than the realized variance of the index exceeds (or is less than) the applicable fixed amount under the index variance swap, and vice versa.

The variance of a basket or index is determined by the variances of, and correlations among, its components. In general, an increase in the variance of a basket or index would be expected to be relatively less than the increase in the variances of its components, and a decrease in the variance of a basket or index would be expected to be relatively greater than the decrease in the variances of its components, in each case if the correlation among the components is relatively lower. Accordingly, the dispersion buyer may be said to be “short” correlation among the components and the dispersion seller may be said to be “long” correlation among the components. Please refer to Section II.K – “General characteristics of correlation-linked Transactions” – of the General Disclosure Statement for a discussion of correlation generally and “Correlation Swaps – Correlation generally” below for a discussion of certain factors that affect the correlation among equity securities.

Because a variance dispersion swap consists of a combination of variance swaps, you should refer to the discussion relating to variance swaps in “Variance Swaps” above and in Section II.J – “General characteristics of variance- and volatility-linked Transactions” – of the General Disclosure Statement, as well as Section III.N – “Combination Transactions” – of the General Disclosure Statement.

The individual variance swaps that are comprised by a variance dispersion swap are treated as separate transactions. Accordingly, certain events may occur that result in an adjustment with respect to the index variance swap but not to any or all of the component variance swaps, or vice versa. For example, if a market disruption event occurs on one or more days with respect to one or a small number of the components, an adjustment to the price of the affected components may be made for purposes of the relevant component variance swaps but not in the calculation of the level of the index for purposes of the index variance swap. Alternatively, if the index is modified or cancelled, the calculation of the level of the index may be adjusted for purposes of the index variance swap, a substitute index may be selected or the index variance swap may be terminated, any of which could affect the payoff on the index variance swap without any offsetting or comparable adjustment being made to the component variance swaps. If any of the individual variance swaps are terminated, the close-out payment may be based on an estimation of the variance of the relevant Underlier over the remaining original term of the relevant individual variance swap at the time of termination, which may differ from realized variance over that remaining period, and which could affect the net payoff under the variance dispersion swap. Please refer to “Market Disruption Events” and “Changes to an Index” above.

In some cases, your objective in entering into a variance dispersion swap may be to hedge or offset other exposure you may have. There can be no assurance that prior observed relationships, if any, between the exposure conferred by a variance dispersion swap and such other exposure will continue, or that payments under the variance dispersion swap will match such other exposure. See Section II.H – “No assurance of Transactions achieving your desired hedging objectives” – of the General Disclosure Statement.

## **Correlation Swaps**

In a typical correlation swap, a “correlation buyer” and a “correlation seller” agree to exchange payments based on the difference between (A) an amount proportional to the observed correlation (as defined under the terms of the correlation swap) among the prices or levels of the components of a basket or index over a stated observation period and (B) a fixed amount that is agreed upon at execution. If (A) is greater than (B), the correlation buyer receives the difference from the correlation seller, and if (A) is less than (B), the correlation buyer pays the absolute value of the difference to the correlation seller.

A correlation swap referencing a basket or index of equity securities will generally have the characteristics and risks described in Section II.K – “General characteristics of correlation-linked Transactions” – of the General Disclosure Statement.

The factors that determine fluctuations in the price of an equity security may be divided into two categories: (i) factors that are unique to that equity security, such as the issuer’s financial performance; and (ii) systematic factors that affect the broader market generally. In general, the greater the effect of systematic factors on equity prices, the greater the degree of correlation. For example, in broad market sell-offs, many stocks will decline at the same time and will therefore tend to exhibit a higher degree of correlation. Conversely, in times where the broader market is not exhibiting any clear trend, correlation may tend to be lower.

The components of a particular basket may include equity securities, indices of equity securities or non-equity components. If certain extraordinary events occur with respect to any of the components included in the basket, the correlation swap may provide that a replacement component will be substituted for the original component as to which the extraordinary event occurred. The terms of the correlation swap will define “extraordinary event” and will specify how the replacement component will be selected. The substitution of replacement components for one or more of the components originally in the basket may affect the level of correlation that is realized over the relevant observation period. If the calculation agent or other determining party has discretion to select replacement components, the terms of the correlation swap may specify any parameters that apply to the selection, and the calculation agent or other determining party may make that determination in a manner that is adverse to your interests. Please refer to Section IV.A.6 – “Act as calculation agent, valuation agent, collateral agent, or determining party” – of the General Disclosure Statement.

The terms of the correlation swap may provide for adjustments to be made to the components of the basket or index in certain circumstances, such as upon the occurrence of extraordinary or ordinary dividends on equity securities included in the basket or index. Such adjustments, which may be subject to some discretion on the part of the calculation agent or other determining party if so provided under the terms of the correlation swap, may have the effect of smoothing, or

reducing the magnitude of, changes in the levels of the underlying components, which may affect the level of correlation that is realized over the relevant observation period.

In some cases, your objective in entering into a correlation swap may be to hedge or offset other exposure you may have. There can be no assurance that prior observed relationships, if any, between realized correlation and such other exposure will continue, or that payments under the correlation swap will match such other exposure. See Section II.H – “No assurance of Transactions achieving your desired hedging objectives” – of the General Disclosure Statement.

## **Dividend Swaps**

In a typical dividend swap, one party (the “fixed amount payer”) agrees to pay the other party a fixed amount (the “fixed amount”) that may reflect an estimate or projection of dividends that will be paid during a specified future period on the equity securities of a specified issuer or of the issuers included in a specified equity index, and the other party (the “dividend amount payer”) agrees to pay to the fixed amount payer an amount (the “dividend amount”) based on the actual amount of such dividends with ex-dividend dates during that period. If the dividend amount exceeds the fixed amount, the dividend amount payer will owe a net payment to the fixed amount payer on the applicable payment date. Conversely, if the dividend amount is less than the fixed amount, the fixed amount payer will owe a net payment to the dividend amount payer on the applicable payment date.

Dividends are subject to significant and rapid change as a result of unanticipated events. When companies make changes in their dividend policies, those changes frequently result in very significant percentage changes from prior dividend levels. For example, a company that experiences adverse financial conditions may cut its dividend by a significant magnitude, such as 50% or 75%, or may cease paying dividends altogether. Alternatively, a company that previously paid no dividend may adopt a regular dividend at a significant level. Although most investments are subject to risks associated with unanticipated future events, dividend swaps are particularly subject to these risks as a result of the large magnitude that is often associated with unanticipated changes in dividend policies.

The fact that a dividend swap references dividends paid by the companies included in a basket or index may not significantly reduce these risks, because dividend levels for many companies are driven by similar factors and, therefore, may be highly correlated. This would be particularly true for a dividend swap referencing an index composed of companies in a single industry or located in a particular geographic region. An index may also provide little diversification benefit if one or a small number of companies represent a significant weight in the index, such that a significant change in the dividend policies of one of these companies may have a significant effect on the overall dividends paid on the index. Because dividends are more likely to be paid by larger companies, and many companies do not pay dividends, it is not uncommon for a significant portion of the dividends paid on a broad-based, market capitalization-weighted index to be attributable to a relatively small number of companies. In that case, a significant change in the dividend policies of one or a small number of companies, or a change in the constituents of the index as a result of corporate events, a change made by the index publisher or otherwise, may have a significant effect on dividends paid on the index. Please refer to “Changes to an Index” above.

Dividend levels are affected by numerous factors, including the following:

- *Economic conditions.* If economic conditions decline generally or in relevant markets, or if uncertainty about future economic conditions increases, dividend levels may decline significantly.
- *Tax policy.* If the tax rate applicable to dividends increases, that may lead to an increase in dividends before the tax rate takes effect, and a decline in dividends thereafter. Dividend levels may also be affected by tax rates applicable to alternatives to dividends, such as share repurchases.
- *Stock market levels.* If companies perceive that their shares are undervalued, they may regard share buybacks as a superior alternative to dividends. Moreover, if companies perceive that the shares of potential acquisition targets are undervalued, companies may prefer to use cash for acquisitions rather than dividends.
- *Interest rates.* Because stocks are an alternative investment to interest-paying bonds, the dividend yield on stocks may be influenced by the yield that is available on bonds.
- *Inflation.* If companies' profits rise as a result of inflation, dividends may increase as a result.
- *Governmental actions.* Certain companies in regulated industries, such as financial institutions and insurance companies, must receive permission from governmental authorities before they may pay dividends. It may be difficult to predict whether or when the relevant authorities will permit dividends to be paid, and in what amounts.

The dividends that will be taken into account in determining the dividend amount (the “relevant dividends”) will be specified under the terms of the dividend swap. Relevant dividends may not include all dividends. For example, the relevant dividends may be limited to ordinary cash dividends or may include other types of dividends, such as extraordinary dividends or non-cash dividends. If relevant dividends do not include extraordinary dividends, the calculation agent or other determining party under the dividend swap may be required to exercise judgment in determining whether particular dividends (or any portion thereof) are ordinary or extraordinary and may make that determination in a manner that is adverse to your interests. Please refer to Section IV.A.6 – “Act as calculation agent, valuation agent, collateral agent, or determining party” – of the General Disclosure Statement. In the case of a dividend swap on an equity index, the relevant dividends typically exclude any dividend for which an adjustment is made in the calculation of the level of the equity index.

For purposes of determining the dividend amount, the amount of the relevant dividends may be multiplied by a fixed percentage (which is less than 100%) or may be subject to reduction for taxes or other items, as specified under the terms of the dividend swap. In that case, the fixed amount payer may receive less, or be required to pay more, under the dividend swap than it would be if the dividend amount were determined based on the full amount of the relevant dividends.

If the dividend amount is determined based on the amount of any relevant dividend that has been declared but not yet paid by the date of determination, and if the amount of such relevant dividend actually paid subsequent to such date differs from the amount declared, an adjustment

may be made to the dividend amount, which may require one party to make a payment to the other party subsequent to the original payment date.

If the fixed amount payer is entitled to receive a net payment from the dividend amount payer in respect of relevant dividends paid during a particular period, the fixed amount payer will receive such payment at the end of such period, and not when the relevant dividends are actually paid. Unless otherwise specified under the terms of the dividend swap, the fixed amount payer will not receive any interest or other compensation with respect to the period between actual payment of the relevant dividends and the payment from the dividend amount payer under the dividend swap.

The value of a dividend swap at any given time will depend substantially on expectations at that time with respect to the amount of relevant dividends that will be paid in the applicable period. These expectations may vary among market participants and may change over time. When we calculate the value of a dividend swap, our expectations about dividends over the applicable period may differ from your expectations or the expectations of any other person. When we calculate the value of a dividend swap for any purpose, including in the event of early termination of a dividend swap, our interests will be adverse to yours. See IV.A.6 – “Conflicts of Interest and Material Incentives – Our financial market activities may adversely impact Transactions – Act as calculation agent, valuation agent, collateral agent, or determining party” – of the General Disclosure Statement.

In some cases, your objective in entering into a dividend swap may be to hedge or offset other exposure you may have. There can be no assurance that prior observed relationships, if any, between dividends and such other exposure will continue, or that payments under the dividend swap will match such other exposure. See Section II.H – “No assurance of Transactions achieving your desired hedging objectives” – of the General Disclosure Statement.

### **Equity Transactions with Forward- or Option-like Features or Economics**

Equity Transactions may include features that are economically similar or equivalent to forwards or options on equity securities, baskets or indexes of equity securities or related listed derivatives contracts. You should be aware, however, that not all contracts or transactions with such features are Equity Transactions or Transactions and that various differences in the applicable regulatory regimes and other circumstances may follow from this distinction. Please see Section II.A – “Arm’s length contractual counterparty to Transactions” – of the General Disclosure Statement.

A forward is an agreement under which one party is obligated to deliver an Underlier or make a payment of equivalent value on or as of a specified future date and the other party is obligated to pay a price (the “forward price”) that is fixed (or in some cases determined under a formula, the parameters of which are fixed) on the trade date. Common variations, which may be applicable under the terms of an Equity Transaction, may include:

- cash settlement based on the difference between forward price and the value of the Underlier determined as of a date or during an averaging period prior to settlement;
- prepayment of the forward price (in which case the party purchasing the Underlier has credit exposure to the other party); and

- variable obligation forwards, which contain embedded put and/or call option economics whereby the seller may retain exposure during the term of the forward to a portion of the return of the Underlier (delimited by cap and/or floor prices).

Equity Transactions with option-like features have the risks and characteristics described in Section III.J – “Option Transactions present special considerations” – of the General Disclosure Statement. In particular, you should review and understand the conditions and requirements for exercising an option feature, as described in such Section III.J. Although there are significant differences between Equity Transactions and listed equity options (see the General Disclosure Statement, including in particular Sections III.B, C, E and I), some of the considerations discussed in the document “Characteristics and Risks of Standardized Options”, including the supplements thereto, published by the Options Clearing Corporation may be relevant to Equity Transactions between you and us.

You should review and understand the effect of market disruptions on the exercise and expiration of any option-like features and on the operation of any automatic exercise provisions (which may require a valuation of the Underlier to determine if the option is in-the-money). Please refer to Section IV.A.2 – “Trade for our own account or the account of customers” – of the General Disclosure Statement for certain considerations regarding potential hedging activities in respect of options.

### **Equity Transactions which may involve delivery of an Underlier or component**

If you enter into an Equity Transaction under which you are permitted or may be required to make or take delivery of an Underlier or a component of an Underlier, you should understand any applicable restrictions on your ability to make or take such delivery, including under applicable securities laws. The party delivering equity securities may be deemed to make certain representations, including that the securities are free of liens and freely transferable under applicable securities laws, and give certain indemnities for failing to deliver. Depending on the terms of the Equity Transaction, one or both of the parties may have the ability to elect, subject to specified conditions, between cash and physical settlement. You should understand any restrictions, under applicable law (including with respect to awareness of material, non-public information) or the terms of an Equity Transaction, on making such an election. Settlement risk may be present in a physically-settled Equity Transaction if the parties do not use a mechanism for delivery-versus-payment (DVP) settlement.

You should be aware, however, that not all contracts or transactions with such physical delivery features are Equity Transactions or Transactions and that various differences in the applicable regulatory regimes and other circumstances may follow from this distinction. Please see Section II.A – “Arm’s length contractual counterparty to Transactions” – of the General Disclosure Statement.