

Digital Asset Disclosures

Digital Asset Risk Factors

Unique Features of Digital Assets: Crypto currencies are not legal tender in the United States. The level of the intrinsic values of digital assets may be subject to a broad spectrum of opinions. The price of many digital assets is based on the agreement of the parties to a transaction. There are specific risks associated with the unique features of digital assets which need to be understood.

Price Volatility: The price of a digital asset is based on the perceived value of the digital asset and can be subject to changes in sentiment, which may make these products highly volatile. Certain digital assets, such as some crypto currencies have experienced daily price volatility of more than 20%. Prospective investors should be aware of the potentially extreme price volatility of some digital assets and the possibility of rapid and substantial price movements, which could potentially result in significant losses.

Valuation and Liquidity: Digital assets can be traded through privately negotiated transactions and through numerous digital assets exchanges and intermediaries around the world. The lack of a centralised pricing source may pose a variety of valuation challenges. In addition, the dispersed liquidity may pose challenges for market participants trying to exit a position, particularly during periods of stress. Brevan Howard has valuation policies and procedures for assets, including digital assets, that take into account their access to liquidity and the volatility of relevant markets.

Cybersecurity: The cybersecurity risks of crypto currencies and related “wallets” or spot exchanges include hacking vulnerabilities and a risk that publicly distributed ledgers may not be immutable. A cybersecurity event could potentially result in a substantial, immediate and irreversible loss for market participants that trade digital assets. Even a minor cybersecurity event in a digital asset is likely to result in downward price pressure on that product and potentially other digital assets.

Technology: The relatively new and rapidly evolving technology underlying digital assets introduces unique risks. For example, a unique private key is required to access, use or transfer a crypto currency on a blockchain or distributed ledger. The loss, theft or destruction of a private key may result in an irreversible loss. The ability to participate in forks (a change in the blockchain’s protocol that the software uses to decide whether a transaction is valid or not) could also have implications for investors. For example, a market participant holding a crypto currency position through a crypto currency exchange may be adversely impacted if the exchange does not allow its customers to participate in a fork that creates a new product.

Opaque Spot Market: Crypto currency balances are generally maintained as an address on the blockchain and are accessed through private keys, which may be held by a market participant or a custodian. Although crypto currency transactions are typically publicly available on a blockchain or distributed ledger, the public address does not identify the controller, owner or holder of the private key. Unlike bank and brokerage accounts, digital assets exchanges and custodians that hold digital assets do not always identify the owner. The opaque underlying or spot market may pose asset verification challenges for market participants, regulators and auditors and potentially give rise to an increased risk of manipulation and fraud.

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Digital Asset Exchanges, Intermediaries and Custodians: Digital asset exchanges, as well as other intermediaries, custodians and vendors used to facilitate digital assets transactions, are relatively new and largely unregulated in both the United States and many foreign jurisdictions. Crypto currency exchanges generally purchase crypto currencies for their own account on the public ledger and allocate positions to customers through internal bookkeeping entries while maintaining exclusive control of the private keys. Under this structure, crypto currency exchanges collect large amounts of customer funds for the purpose of buying and holding virtual currencies on behalf of their customers. The opaque underlying spot market and lack of regulatory oversight potentially creates a risk that a crypto currency exchange may not hold sufficient crypto currencies and funds to satisfy its obligations and that such deficiency may not be easily identified or discovered. Many digital asset exchanges have experienced significant outages, downtime and transaction processing delays and may have a higher level of operational risk than regulated futures or securities exchanges.

Regulatory Landscape: Digital assets currently face an uncertain regulatory landscape in the United States and many foreign jurisdictions. In the United States, digital assets are not subject to federal regulatory oversight but may be regulated by one or more state regulatory bodies. In addition, many digital asset derivatives are regulated by the CFTC, and the SEC has cautioned that many initial coin offerings are likely to fall within the definition of a security and subject to U.S. securities laws. One or more jurisdictions may, in the future, adopt laws, regulations or directives that affect digital asset networks and their users. Such laws, regulations or directives may impact the price of digital assets and their acceptance by users, merchants and service providers.

Transaction Fees: Many crypto currencies allow market participants to offer miners (i.e., parties that process transactions and record them on a blockchain or distributed ledger) a fee. A fee is generally necessary to ensure that a transaction is promptly recorded on a blockchain or distributed ledger. The amounts of these fees are subject to market forces and it is possible that the fees could increase substantially during a period of stress. In addition, digital asset exchanges, wallet providers and other custodians may charge high fees relative to custodians in many other financial markets.

Digital Asset Derivatives: Digital asset derivatives may experience significant price volatility and the initial margin for digital asset derivatives may be set as a percentage of the value of a particular contract, which means that margin requirements for long positions can increase if the price of the contract rises. In addition, some futures commission merchants may pose restrictions on customer trading activity in digital asset derivatives, such as requiring additional margin, imposing position limits, prohibiting naked shorting or prohibiting give-in transactions. The rules of certain designated contract markets impose trading halts that may restrict a market participant's ability to exit a position during a period of high volatility.

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