



## **FORM ADV - Part 2A Brochure**

### **ARROWGRASS CAPITAL PARTNERS (US) LP**

**March 14, 2012**

This brochure ("Brochure") provides information about the qualifications and business practices of Arrowgrass Capital Partners (US) LP ("Arrowgrass US"), located at 1330 Avenue of the Americas, 32<sup>nd</sup> Floor, New York, NY 10019.

If you have any questions about the contents of this Brochure, please contact our Chief Compliance Officer, Stephen Ellwood, at (212) 584-1161 or [compliance@arrowgrass.com](mailto:compliance@arrowgrass.com). The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission ("SEC") or by any state securities authority.

Additional information about Arrowgrass US is also available on our website (<http://www.arrowgrass.com>) or on the SEC's website (<http://www.advisorinfo.sec.gov>).

Arrowgrass US is a registered investment adviser under the Investment Advisers Act of 1940 (the "Advisers Act"). Recipients of this Brochure should be aware that registration with the SEC does not in any way constitute an endorsement by the SEC of an investment adviser's skill or expertise.

This Brochure does not constitute an offer to sell or solicitation of an offer to buy any securities.

**ITEM 2**  
**MATERIAL CHANGES**

Arrowgrass Capital Partners (US) LP's most recent update to Part 2 of Form ADV was made in June 2011. Arrowgrass Capital Partner (US) LP's business activities have not materially changed since the time of that update. This Brochure updates our assets under management, the registration status of Arrowgrass Capital Partners LLP and removes all references to Arrowgrass Vega Fund Limited, Arrowgrass Vega International Limited and Arrowgrass Vega LP (collectively, the "Vega Funds"). The Vega Funds are being dissolved and are no longer offered to investors.

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## ITEM 4

### ADVISORY BUSINESS

Arrowgrass US, a Delaware limited partnership, was formed in 2007 and began trading on behalf of its clients in 2008. Arrowgrass Capital Partners II LLP, which has a majority limited partnership interest in Arrowgrass US, and Nicholas Graham Niell, who has a majority interest in Arrowgrass Capital Partners II LLP, are the principal owners of Arrowgrass US. Arrowgrass Capital Services (US) Inc. acts as general partner of Arrowgrass US and has ultimate responsibility for the management, operations and the investment decisions made by Arrowgrass US.

Arrowgrass US serves as investment adviser with discretionary trading authority for private pooled investment vehicles, the securities of which are offered to investors on a private placement basis (each, a “Fund” and, collectively, the “Funds”).

Arrowgrass US, along with Arrowgrass Capital Partners LLP (“Arrowgrass UK”, and together with Arrowgrass US, “Arrowgrass”), an English limited liability partnership registered with the SEC as an investment adviser pursuant to the Advisers Act and regulated by the Financial Services Authority (“FSA”), have both been appointed to serve jointly as investment adviser with discretionary trading authority to the following Funds:

- A. Arrowgrass Master Fund Ltd, a Cayman Islands exempted company, into which Arrowgrass International Fund Ltd, a Cayman Islands exempted company, and Arrowgrass Partnership LP, a Delaware limited partnership, invest substantially all of their assets through a “master feeder” structure.
- B. Arrowgrass Equity Focus Fund Limited, a Cayman Islands exempted company, into which Arrowgrass Equity Focus International Limited, a Cayman Islands exempted company, and Arrowgrass Equity Focus LP, a Delaware limited partnership, invest substantially all of their assets through a “master feeder” structure.
- C. Arrowgrass Distressed Opportunities Fund Limited, a Cayman Islands exempted company, into which Arrowgrass Distressed Opportunities International Limited, a Cayman Islands exempted company, and Arrowgrass Distressed Opportunities LP, a Delaware limited partnership, invest substantially all of their assets through a “master feeder” structure.

Arrowgrass International Fund Ltd, Arrowgrass Equity Focus International Limited and Arrowgrass Distressed Opportunities International Limited are each referred to herein as an “Overseas Fund” and, collectively, as the “Overseas Funds.” Arrowgrass Partnership LP, Arrowgrass Equity Focus LP and Arrowgrass Distressed Opportunities LP are each referred to herein as a “Domestic Fund” and, collectively, as the “Domestic Funds.”

Arrowgrass Investment Management Ltd (the “Manager”), a Cayman Islands limited company which wholly owns Arrowgrass Capital Services (US) Inc., acts as manager to the Funds. The Manager and the Funds have appointed Arrowgrass US and Arrowgrass UK to provide discretionary investment management services to the Funds. Arrowgrass General Partner Limited (the “General Partner”), a Cayman Islands exempted company, serves as general partner to the Domestic Funds.

As used herein, the term “client” generally refers to each Fund.

*This Brochure generally includes information about Arrowgrass US and its relationships with its clients. While much of this Brochure applies to all such clients, certain information included herein applies to specific clients only.*

Arrowgrass US's investment decisions and advice with respect to each Fund are subject to each Fund's investment objectives and guidelines, as set forth in its offering documents. Please see Item 8 for a description of the investment strategies employed by Arrowgrass US.

As of December 31, 2011, Arrowgrass US had \$3,616,710,996 in discretionary assets under management across the Funds and does not manage any assets on a non-discretionary basis.

## **ITEM 5**

### **FEES AND COMPENSATION**

The fees applicable to each Fund are set forth in detail in each Fund's offering documents. A brief summary of such fees is provided below.

#### **Domestic Funds**

##### **Management Fee and Incentive Allocation**

Generally, the Manager receives a management fee (the "Domestic Management Fee") from each Domestic Fund equal to 1 to 2 per cent per annum of each investor's capital account paid monthly or fortnightly in arrears. The General Partner may, in its sole and absolute discretion, elect to reduce, waive or calculate differently the Domestic Management Fee with respect to any investor.

Generally, at the end of each fiscal year of each Domestic Fund, 10 to 20 per cent of the excess of any net capital appreciation allocated to the capital account of each investor in such Domestic Fund for such year over the Domestic Management Fee debited to such investor's capital account for such year is reallocated to the capital account of the General Partner, subject to a loss carryforward mechanism (the "Incentive Allocation").

In the event that an investor withdraws all or a portion of its capital account other than at the end of a fiscal year, net capital appreciation or net capital depreciation, as the case may be, allocable to such investor will be determined through the date of withdrawal and the Incentive Allocation, if any, with respect to the amount withdrawn will be reallocated to the General Partner as set forth above. The General Partner may, in its sole and absolute discretion, elect to reduce, waive or calculate differently the Incentive Allocation with respect to any investor.

The General Partner pays the Manager an incentive fee from the Incentive Allocation the General Partner receives. The Manager pays Arrowgrass US from such incentive fee and the Domestic Management Fee such fees as are from time to time agreed between them.

#### **Overseas Funds**

##### **Management Fee and Incentive Fee**

Generally, the Manager receives a management fee (the "Overseas Management Fee") from each Overseas Fund equal to 1 to 2 per cent per annum of each series of shares (excluding management shares) of each Overseas Fund paid monthly or fortnightly in arrears. The Manager or Arrowgrass may, at its sole discretion, rebate such fees to certain investors.

Generally, at the end of each fiscal year of each Overseas Fund, the Manager is entitled to an incentive fee (the "Incentive Fee") in an amount equal to 10 to 20 per cent of the net realized and unrealized appreciation in the net asset value of each series of shares, adjusted for any redemption of shares in the series made during the year, any distributions and any accruals of the Incentive Fee, and subject to a loss carryforward mechanism. The Manager or Arrowgrass may, at its sole discretion, rebate such fees to certain investors.

In the event that shares are redeemed other than at the end of a fiscal year, the Incentive Fee is determined solely with respect to the shares so redeemed as of the redemption date. In the event

that services by the Manager to the relevant Overseas Fund is terminated other than at the end of a fiscal year, the Incentive Fee with respect to such Overseas Fund will be determined as of the termination date.

The Manager pays Arrowgrass US from the Management Fee and Incentive Fee such fees as are from time to time agreed between them.

### **Expenses**

Not all of the Funds bear all of the expenses set forth below. The expenses that the Funds may bear are as follows:

To the extent permitted under the applicable offering documents, each Fund bears its own operating and other expenses, including, but not limited to, (a) any applicable management fee or incentive fee/allocation and administrator's fees; (b) the costs and expenses of (i) sourcing, researching and evaluating potential investments for the Fund's portfolio (including, but not limited to, professional fees charged by legal advisers, tax advisers, valuation experts and accountants) irrespective of whether an investment is subsequently made by the Fund; (ii) all investments and transactions carried out by it or on its behalf (including costs and expenses (including travel expenses) incurred by Arrowgrass) specifically associated with researching investment opportunities; and (c) the administration of the Fund including (without limitation): (i) the costs and expenses associated with structuring any transaction including "finder's fees"; (ii) the costs of any independent research and/or portfolio management systems utilized by Arrowgrass; (iii) brokers' commissions (if any), borrowing charges on securities sold short and any issue or transfer taxes chargeable in connection with any securities transactions; (iv) the fees and expenses of independent valuation agents; (v) all taxes and corporate fees payable to governments or agencies; (vi) Fund's directors' fees (if any) and expenses; (vii) interest on borrowings, including borrowings from the prime brokers and custodians; (viii) such expenses incurred by Arrowgrass in soliciting subscriptions for shares as shall be approved by the Fund's directors; (ix) communication expenses with respect to investor services and all expenses of meetings of shareholders and of preparing, printing and distributing financial and other reports, proxy forms, prospectuses and similar documents; (x) the cost of insurance (if any) for the benefit of the Fund's directors; (xi) litigation and indemnification expenses and extraordinary expenses not incurred in the ordinary course of business; (xii) listing fees and charges; (xiii) the cost of obtaining and maintaining SAS 70 certification (or equivalent) in respect of Arrowgrass' operations, which the Fund's directors deem to be for the benefit of investors generally; (xiv) the costs and expenses associated with the business of the trading subsidiaries (including, but not limited to, directors' fees, costs of any substance offices required and legal and accounting fees); (xv) any financing costs for any standalone total return swap or warehousing facility put in place to fund the Fund's investments; and (xvi) all other organizational and operating expenses as approved by the Fund's directors (including without limitation any administrative costs associated with seeking approvals for transactions which may involve a conflict of interest).

Please also refer to the disclosure made in Item 12 related to Brokerage Practices for further discussion of brokerage and other transaction costs.

Neither Arrowgrass US nor any of its supervised persons accepts compensation (e.g., brokerage commissions) for the sale of securities or other investment products.

**ITEM 6**  
**PERFORMANCE BASED FEES AND SIDE-BY-SIDE MANAGEMENT**

Arrowgrass US accepts performance-based fees with respect to all Domestic Funds and Overseas Funds as more fully described in Item 5 above. The variation of performance-based fee structures among the Funds may create an incentive for Arrowgrass US to direct the best investment ideas to, or to allocate or sequence trades in favor of, particular Funds to the disadvantage of other Funds. Additionally, performance-based fee arrangements may create an incentive for Arrowgrass US to recommend investments that may be riskier or more speculative than would be the case in the absence of such compensation.

Arrowgrass US is committed to allocating investment opportunities on a fair and equitable basis and has established policies and procedures to address the conflicts of interest described above, as further described in Item 11.



**ITEM 7**  
**TYPES OF CLIENTS**

Arrowgrass US provides investment advice to private investment pools, as described in Item 4 above.

**ITEM 8**  
**METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS**

**Method of Analysis and Investment Strategies.**

*The descriptions set forth in this Brochure of specific advisory services that Arrowgrass US offers to clients, and investment strategies pursued and investments made by Arrowgrass US on behalf of its clients, should not be understood to limit in any way Arrowgrass US's investment activities. Arrowgrass US may offer any advisory services, engage in any investment strategy and make any investment, including any not described in this Brochure, that Arrowgrass US considers appropriate, subject to each client's investment objectives and guidelines. The investment strategies Arrowgrass US pursues are speculative and entail substantial risks. There can be no assurance that the investment objectives of any client will be achieved.*

The following is a summary of the investment strategies and methods of analysis employed by Arrowgrass US on behalf of the Funds.

Arrowgrass US currently seeks to achieve the investment objectives of the Funds by: (i) investing on a global basis pursuant to convertible arbitrage, volatility arbitrage, capital structure arbitrage, merger arbitrage, distressed and special situations strategies with a macro hedging overlay, (ii) following a European-focused long/short equity strategy, (iii) following a long-only equity volatility strategy and (iv) investing in liquid corporate distressed assets in Europe and the United States.

Arrowgrass US engages in significant research regarding each prospective and existing investment. In general, Arrowgrass US's research process is a proprietary blend of fundamental/strategic analysis, catalyst identification and economic value added analysis. In conducting such research, Arrowgrass US may consult the following sources of information: financial newspapers and magazines, inspections of corporate activities, research materials prepared by others, corporate rating services, annual reports, prospectuses, filings with the SEC, company press releases, and any other material it deems relevant. Arrowgrass US engages the services of experts and consultants to supplement its research.

Specific descriptions of such strategies and methods, and a full description of the risks associated with such strategies and methods, are included in each Fund's offering documents, subscription agreement, or other constituent documents.

**Material, Significant or Unusual Risks Relating to Investment Strategies and Risks Associated With Particular Types of Securities.**

Arrowgrass has a Risk Committee and has adopted unique risk policies for each Fund, which include, *inter alia*, concentration, liquidity and stop-loss limits relevant to that Fund's trading strategy. However, as with any investment, the Funds' investment strategies have the potential for complete loss of capital.

Complete descriptions of the risks associated with investment in a Fund are included in each Fund's offering documents, subscription agreement, or other constituent documents. Some or all of the following risks may be applicable to a Fund depending upon its investment program and restrictions.

*The following risk factors do not purport to be a complete list or explanation of the risks involved in an investment in the clients advised by Arrowgrass US. These risk factors include only those risks Arrowgrass US believes to be material, significant or unusual and relate to particular significant*

*investment strategies or methods of analysis employed by Arrowgrass US. Participation in the Funds is only suitable for investors who have knowledge and expertise in financial and business matters and are capable of evaluating the merits and risks of an investment in a Fund. Investment in the Funds involves the risk of total loss of capital.*

(i) Arbitrage.

Arrowgrass US may cause a Fund to engage in arbitrage investments and may incur significant losses if proposed transactions are not consummated. The consummation of mergers, tender offers and exchange offers can be prevented or delayed by a variety of factors, including: (i) opposition of the management or shareholders of the target company, which often results in litigation to enjoin the proposed transaction; (ii) intervention of government agencies; (iii) efforts by the target company to pursue a defensive strategy, including a merger with, or a friendly tender offer by, a company other than the offeror; (iv) an attempt by a third party to acquire the offeror; (v) in the case of a merger, failure to obtain the necessary shareholder approvals; (vi) market conditions resulting in material changes in securities prices; (vii) compliance with any applicable legal requirements; and (viii) inability to obtain adequate financing.

Arrowgrass US will compete with firms, including many of the larger investment banking firms, which have substantially greater financial resources, larger research teams and more securities traders than will be available to Arrowgrass US. In any given transaction, arbitrage activity by other firms will tend to narrow the spread between the price at which a security may be purchased by a Fund and the price it expects to receive upon consummation of the transaction thereby reducing such Fund's opportunity for profit.

The success of a Fund's investment activities will depend on Arrowgrass US's ability to identify and exploit price discrepancies in the market. Identification and exploitation of market opportunities involve uncertainty. No assurance can be given that Arrowgrass US will be able to locate investment opportunities or to correctly exploit price discrepancies. A reduction in the pricing inefficiency of the markets in which a Fund will seek to invest will reduce the scope for such Fund's investment strategies. In the event that the perceived mispricings underlying a Fund's positions were to fail to materialize as expected by Arrowgrass US, such Fund could incur a loss.

(ii) Convertible Securities.

Convertible securities are bonds, debentures, notes, preferred stocks or other securities that may be converted into or exchanged for a specified amount of common stock of the same or different issuer within a particular period of time at a specified price or formula. A convertible security entitles the holder to receive interest that is generally paid or accrued on debt or a dividend that is paid or accrued on preferred stock until the convertible security matures or is redeemed, converted or exchanged. Convertible securities generally (i) have higher yields than common stocks, but lower yields than comparable non-convertible securities, (ii) are less subject to fluctuation in value than the underlying common stock due to their fixed-income characteristics and (iii) provide the potential for capital appreciation if the market price of the underlying common stock increases. The value of a convertible security is a function of its "investment value" (determined by its yield in comparison with the yields of other securities of comparable maturity and quality that do not have a conversion privilege) and its "conversion value" (the security's worth, at market value, if converted into the underlying common stock). A convertible security generally will sell at a premium over its conversion value by the extent to which investors place value on the right to acquire the underlying common stock while holding a fixed-income security. Generally, the amount of the premium decreases as the convertible security approaches maturity. A convertible security may be subject to

withdrawal at the option of the issuer at a price established in the convertible security's governing instrument. If a convertible security held by a Fund is called for redemption, that Fund will be required to permit the issuer to redeem the security, convert it into the underlying common stock or sell it to a third party. Any of these actions could have an adverse effect on that Fund.

(iii) Illiquid Portfolio Instruments.

Arrowgrass US may cause a Fund to invest in illiquid investments and such Fund may not be able to readily dispose of such illiquid investments and, in some cases, may be contractually prohibited from disposing of such investments for a specified period of time.

All positions in the Funds' investment portfolio are valued at fair value. Positions that are illiquid and do not actively trade will be marked to market, taking into account actual market prices, market prices of comparable investments and/or such other factors (*e.g.*, the tenor of the respective instrument) as may be appropriate. To the extent that marking an illiquid investment to market is not practicable, an investment will be carried at fair value, as reasonably determined by the directors of a Fund or their delegate. There is no guarantee that fair value will represent the value that will be realized by a Fund on the eventual disposition of the investment or that would, in fact, be realized upon an immediate disposition of the investment.

(iv) Event-Driven Investing.

Event-driven investing requires Arrowgrass US to make predictions about (i) the likelihood that an event will occur and (ii) the impact such event will have on the value of a company's securities. If the event fails to occur or it does not have the effect foreseen, losses can result. For example, the adoption of new business strategies or completion of asset dispositions or debt reduction programs by a company may not be valued as highly by the market as Arrowgrass US had anticipated, resulting in losses. In addition, a company may announce a plan of restructuring which promises to enhance value and fail to implement it, resulting in losses to investors. In liquidations and other forms of corporate reorganization, the risk exists that the reorganization either will be unsuccessful, will be delayed or will result in a distribution of cash or a new security, the value of which will be less than the purchase price to a Fund of the security in respect of which such distribution was made. The consummation of mergers and tender and exchange offers can be prevented or delayed by a variety of factors, including: (i) opposition of the management or stockholders of the target company, which will often result in litigation to enjoin the proposed transaction; (ii) intervention of a federal or state regulatory agency; (iii) efforts by the target company to pursue a "defensive" strategy, including a merger with, or a friendly tender offer by, a company other than the offeror; (iv) in the case of a merger, failure to obtain the necessary stockholder approvals; (v) market conditions resulting in material changes in securities prices; (vi) compliance with any applicable federal or state securities laws; and (vii) inability to obtain adequate financing. Any of these factors could lead to loss and have an adverse effect on a Fund.

(v) Shareholder Activism.

From time to time Arrowgrass US may adopt an activist approach to a Fund's investments as a means to improve corporate governance and transparency and to increase shareholder value generally and the valuation of a Fund's holdings in particular. This may include actively seeking to change governance at portfolio companies by initiating proxy fights; filing legal actions in local and international courts, when appropriate; publicizing corporate problems via local and international media; and otherwise bringing pressure to bear on company management to make changes that Arrowgrass US believes maximize shareholder value. This strategy presents a risk of retaliation

against Arrowgrass US or their employees and affiliates by target company management or other interested parties who are impacted by this shareholder activism. This retaliation may include, but is not limited to, counter lawsuits or other judicial claims, bureaucratic harassment, technological interference (hacked computer networks and tapped telephone lines) spurious tax inquiries and other means of intimidation. Arrowgrass US may cause a Fund to invest in jurisdictions with weak government institutions and courts, high levels of bureaucratic corruption and historically fragile property rights. Arrowgrass US will endeavor to employ shareholder activism only when it is in the interests of a Fund's investments and when doing so does not introduce unnecessary risk to a Fund or its investors.

(vi) Small and Medium-Capitalization Companies.

Arrowgrass US may cause a Fund to invest a portion of its assets in the securities of companies with small to medium-sized market capitalizations. While Arrowgrass US believes they often provide significant potential for appreciation, those stocks, particularly small-capitalization stocks, involve higher risks in some respects than do investments in securities of larger companies. For example, prices of small-capitalization and even medium-capitalization securities are often more volatile than prices of large-capitalization securities and the risk of bankruptcy or insolvency of many smaller companies (with the attendant losses to investors) is higher than for larger, "blue-chip" companies. In addition, due to thin trading in the securities of some small-capitalization companies, an investment in those companies may be illiquid.

Investments in small and/or unlisted companies will be subject to a number of significant risks, including (but not limited to) the following: (a) such companies may have limited financial resources and may be unable to meet their obligations in respect of their debt securities in which a Fund may invest; (b) such companies typically have shorter operating histories, narrow product lines and smaller market share than larger or listed businesses, which tend to render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns; (c) such companies are more likely to depend on the management talents and efforts of a small group of people and as a result, death, disability, resignation or termination of one of these individuals could have a material adverse impact on the company and in turn on a Fund's investments in such company; and (d) such companies generally have less predictable operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence and may require additional capital to support their operations, finance expansion or maintain their competitive position. Little public information exists about these companies. The greater difficulty in making a fully informed investment decision raises the risk of misjudging the credit quality of the company and consequently, a Fund may lose money on its investments in such companies.

(vii) Distressed Securities.

Arrowgrass US may cause a Fund to invest in distressed securities. Investments in distressed securities are investments in business enterprises involved in workouts, liquidations, reorganizations, bankruptcies and similar situations. Since there is substantial uncertainty concerning the outcome of transactions involving such business enterprises, there is a high degree of risk of loss by a Fund of its entire investment in such companies. In addition, distressed securities can often be expected to consist of financial instruments or obligations for which no market exists and which are restricted as to their transferability under federal or state securities laws. The sale of such investments may be possible only at substantial discounts. The market prices of distressed securities are also subject to abrupt and erratic market movements and above-average price volatility, and the spread between the bid and asked prices of such securities may be greater than

those prevailing in other securities markets. It may take a number of years for the market price of such securities to reflect their intrinsic value.

(viii) Bankruptcy/Work-Out.

The repayment of defaulted obligations is subject to significant uncertainties. Defaulted obligations might be repaid only after lengthy workout or bankruptcy proceedings, during which the issuer might not make any interest or other payments. Typically such workout or bankruptcy proceedings result only in partial recovery of cash payments or an exchange of the defaulted obligation for other debt or equity securities of the issuer or its affiliates, which may in turn be illiquid or speculative.

There are a number of significant risks inherent in the bankruptcy process. First, many events in a bankruptcy are a product of contested matters and adversary proceedings which may be beyond the control of the creditors. While creditors are generally given an opportunity to object to significant actions, there can be no assurance that a court would not approve actions that would be contrary to the interests of a Fund. Second, the effect of a bankruptcy filing on an issuer may adversely and permanently affect the issuer. The issuer may lose its market position and key employees and otherwise become incapable of restoring itself as a viable entity. If for this or any other reason the proceeding is converted into liquidation, the value of the issuer may not equal the liquidation value that was believed to exist at the time of the investment by a Fund. Third, the duration of a bankruptcy proceeding is difficult to predict. A creditor's return on investment can be adversely affected by delays while a restructuring plan is being negotiated, approved by the creditors and confirmed by a court and until it ultimately becomes effective. Fourth, the administrative costs in connection with bankruptcy proceedings are frequently high and would be paid out of debtor's estate prior to any return to creditors. For example, if a proceeding involves protracted or difficult litigation, substantial assets may be devoted to administrative costs. Fifth, in the early stages of the bankruptcy process, it is often difficult to estimate the extent of, or even to identify, any contingent claims that might be made. Sixth, in certain jurisdictions, creditors can lose their ranking and priority if they exercise "domination and control" over a debtor and other creditors can demonstrate that they have been harmed by such actions. Seventh, certain claims that have priority under relevant local law (for example, claims for taxes) may be substantial. In any investment involving distressed debt obligations, there exists the risk that the transaction involving such debt obligations will be unsuccessful, take considerable time or will result in a distribution of cash or a new security or obligation in exchange for the distressed debt obligations, the value of which may be less than a Fund's purchase price of such debt obligations. Furthermore, if an anticipated transaction does not occur, a Fund may be required to sell its investment at a loss. Given the substantial uncertainties concerning transactions involving distressed debt obligations in which a Fund may invest, there is a potential risk of loss by such Fund of its entire investment in any particular investment.

Arrowgrass US may participate on committees formed by creditors to negotiate with the management of financially troubled companies that may or may not be in bankruptcy or may negotiate directly with debtors with respect to restructuring issues. If Arrowgrass US chooses to join a committee, it would likely be only one of many participants, all of whom might be interested in obtaining an outcome that is in their individual best interests. There can be no assurance that Arrowgrass US would be successful in obtaining results most favorable to a Fund in such proceedings, although such Fund may incur significant legal and other expenses in attempting to do so. As a result of participation by Arrowgrass US on such committees, a Fund may be deemed to have duties to other creditors represented by the committees which might thereby expose such Fund to such other creditors who disagree with Arrowgrass US's actions. Participation by Arrowgrass US on such committees may cause a Fund to be subject to certain restrictions on their ability to trade a particular investment.

(ix) Investments in Undervalued Securities.

Arrowgrass US will seek investment opportunities for the Funds in undervalued securities. The identification of investment opportunities in undervalued securities is a difficult task, and there are no assurances that such opportunities will be successfully recognized or acquired. While investments in undervalued securities offer the opportunity for above-average capital appreciation, these investments involve a high degree of financial risk and can result in substantial losses. Returns generated from a Fund's investments may not adequately compensate for the business and financial risks assumed. In addition, a Fund may be required to hold such securities for a substantial period of time before realizing their anticipated value. During this period, a portion of that Fund's capital would be committed to the securities purchased, thus possibly preventing that Fund from investing in other opportunities on behalf of that Fund. In addition, Arrowgrass US may cause a Fund to finance such purchases with borrowed funds and thus will have to pay interest on such funds during such waiting period.

(x) Fixed Income Securities.

Arrowgrass US may cause a Fund to invest in bonds or other fixed income securities, including, without limitation, commercial paper and "higher yielding" (including non-investment grade) (and, therefore, higher risk) debt securities. A Fund may therefore be subject to credit, liquidity and interest rate risks. Higher-yielding debt securities are generally unsecured and may be subordinated to certain other outstanding securities and obligations of the issuer, which may be secured on substantially all of the issuer's assets. The lower rating of debt obligations in the higher-yielding sector reflects a greater probability that adverse changes in the financial condition of the issuer or in general economic conditions or both may impair the ability of the issuer to make payments of principal and interest. Non-investment grade debt securities may not be protected by financial covenants or limitations on additional indebtedness. In addition evaluating credit risk for debt securities involves uncertainty because credit rating agencies throughout the world have different standards, making comparison across countries difficult. Also, the market for credit spreads is often inefficient and illiquid, making it difficult to accurately calculate discounting spreads for valuing financial instruments. It is likely that a major economic recession could disrupt severely the market for such securities and may have an adverse impact on the value of such securities. In addition, it is likely that any such economic downturn could adversely affect the ability of the issuers of such securities to repay principal and pay interest thereon and increase the incidence of default for such securities.

(xi) Loans.

A portion of a Fund's investments may consist of loans and participations originated by banks and other financial institutions, typically referred to as "bank loans." A Fund's investments may include loans of a type generally incurred by borrowers in connection with highly leveraged transactions, often to finance internal growth, acquisitions, mergers or stock purchases, or for other reasons. As a result of the additional debt incurred by the borrower in the course of the transaction, the borrower's creditworthiness is often judged by the rating agencies to be below investment grade. Such loans are typically private corporate loans which are negotiated by one or more commercial banks or financial institutions and syndicated among a group of commercial banks and financial institutions. In order to induce the lenders to extend credit and to offer a favorable interest rate, the borrower often provides the lenders with extensive information about its business, which is not generally available to the public. Bank loans and other debt obligations that are acquired by a Fund may be below investment grade or not rated at all.

A Fund may acquire interests in bank loans and other debt obligations either directly (by way of transfer or assignment) or indirectly (by way of participation). A Fund may purchase a bank loan by way of a transfer or assignment and typically succeeds to all the rights and obligations of the transferor or assignor institution and becomes a lender under the credit agreement with respect to such bank loan; however, the Fund's rights can be more restricted than those of the transferor or assignor institution for legal or regulatory reasons. A Fund may not be able unilaterally to enforce all rights and remedies under the bank loan and any associated collateral. A participation interest in a portion of a debt obligation typically results in a contractual relationship only with the institution participating out the interest, not with the borrower. In purchasing participations, a Fund generally will have no right to enforce compliance by the borrower with the terms of the loan agreement or any rights of setoff against the borrower and the Fund may not directly benefit from the collateral supporting the debt obligation in which it has purchased the participation. As a result, the Fund will be exposed to the credit risk of both the borrower and the institution selling the participation.

Purchasers of bank loans are predominantly commercial banks, investment funds and investment banks. As secondary market trading volumes increase, new bank loans frequently adopt standardized documentation to facilitate loan trading which should improve market liquidity. However, there can be no assurance that future levels of supply and demand in bank loan trading will provide an adequate degree of liquidity or that the current level of liquidity will continue. Because of the provision to holders of loans of confidential information relating to the borrower, the unique and customized nature of the loan agreement, the limited universe of eligible purchasers and the private syndication of the loan, bank loans are not as easily purchased or sold as a publicly traded security.

*Secured Bank Loans.* Secured bank loans are typically at the most senior level of the capital structure and are sometimes secured by specific collateral, including, but not limited to, trademarks, patents, accounts receivable, inventory, equipment, buildings, real estate, franchises and common and preferred stock of the obligor or its affiliates. Secured bank loans often contain restrictive covenants designed to limit the activities of the borrower in an effort to protect the right of lenders to receive timely payments of principal and interest. Such covenants may include restrictions on dividend payments, specific mandatory minimum financial ratios, limits on total debt and other financial tests. Bank loans usually have shorter terms than subordinated obligations and may require mandatory prepayments from excess cash flow, asset dispositions and offerings of debt and/or equity securities.

*Second Lien Loans.* Second lien loans are subject to the same risks associated with investment in senior loans and non-investment grade securities. However, second lien loans are second in right of payment to senior loans and therefore are subject to additional risk that the cash flow of the borrower and any property securing the loan may be insufficient to meet scheduled payments after giving effects to the senior secured obligations of the borrower. In addition, in certain jurisdictions, the validity and enforceability of second lien loans and any related rights to collateral have not been tested in bankruptcy courts. Second lien loans are expected to have greater price volatility than senior loans and may be less liquid. There is also a possibility that originators will not be able to sell participations in second lien loans, which would create greater credit risk exposure.

*Unsecured Loans.* Unsecured loans are subject to the same risks associated with investment in senior loans and non-investment grade securities. However, because unsecured loans have lower priority in right of payment to any higher ranking obligations of the borrower and are not backed by a security interest in any specific collateral, they are subject to the additional risk that the cash flow of the borrower and available assets may be insufficient to meet scheduled payments after giving effect to any higher ranking obligations of the borrower. Unsecured loans are expected to have



greater price volatility than senior loans, second lien loans and other secured loans and may be less liquid. There is also a possibility that originators will not be able to sell participations in unsecured loans, which would create greater credit risk exposure.

(xii) Trade Claims.

Arrowgrass US may cause a Fund to invest in trade claims. Trade claims are subject to the same risks associated with investments in unsecured loans and other non-investment grade securities. However, because trade claims may have lower priority in right of payment to any higher ranking obligations of the borrower and are typically not backed by a security interest in any specific collateral, they are subject to the additional risk that the cash flow of the borrower and available assets may be insufficient to pay such trade claims after giving effect to any higher ranking obligations of the borrower. Trade claims are expected to have greater price volatility than senior loans, second lien loans and unsecured loans and may be less liquid. There is also a possibility that originators will not be able to sell participations in trade claims, which would create greater credit risk exposure. In addition to the foregoing, there is an additional degree of risk in the settlement process for trade claims, as compared with exchange traded instruments which may result in the settlement of trade claims being delayed.

(xiii) Structured Credit Risk.

Arrowgrass US may cause a Fund to invest in structured credit agreements, each with rates of interest that vary based on a designated floating rate formula or index. The value of these investments is closely tied to the absolute levels of such rates or indices, or the market's perception of anticipated changes in those rates or indices. The movements in specific indices or interest rates may be difficult or impossible to hedge.

(xiv) Leverage and Financing Risk.

A Fund may leverage its capital because Arrowgrass US believes that the use of leverage may enable that Fund to achieve a higher rate of return. Accordingly, a Fund may pledge its securities in order to borrow additional funds for investment purposes. A Fund may also leverage its investment return with options, short sales, swaps, forwards and other derivative instruments. The amount of borrowings which a Fund may have outstanding at any time may be substantial in relation to its capital.

While leverage presents opportunities for increasing a Fund's total return, it has the effect of potentially increasing losses as well. Accordingly, any event which adversely affects the value of an investment by a Fund would be magnified to the extent a Fund is leveraged. The cumulative effect of the use of leverage by a Fund in a market that moves adversely to a Fund's investments could result in a substantial loss to a Fund which would be greater than if that Fund were not leveraged.

In general, the anticipated use of short-term margin borrowings results in certain additional risks to a Fund. For example, should the securities pledged to brokers to secure that Fund's margin accounts decline in value, the Fund could be subject to a "margin call", pursuant to which the Fund must either deposit additional funds or securities with the broker, or suffer mandatory liquidation of the pledged securities to compensate for the decline in value. In the event of a sudden drop in the value of the Fund's assets, the Fund might not be able to liquidate assets quickly enough to satisfy margin requirements.

A Fund may enter into repurchase and reverse repurchase agreements. When a Fund enters into a repurchase agreement, it “sells” securities to a broker-dealer or financial institution, and agrees to repurchase such securities on a mutually agreed date for the price paid by the broker-dealer or financial institution, plus interest at a negotiated rate. In a reverse repurchase transaction, a Fund “buys” securities from a broker-dealer or financial institution, subject to the obligation of the broker-dealer or financial institution to repurchase such securities at the price paid by that Fund, plus interest at a negotiated rate.

The use of repurchase and reverse repurchase agreements by a Fund involves certain risks. For example, if the seller of securities to a Fund under a reverse repurchase agreement defaults on its obligation to repurchase the underlying securities, as a result of its bankruptcy or otherwise, that Fund will seek to dispose of such securities, which action could involve costs or delays. If the seller becomes insolvent and subject to liquidation or reorganization under applicable bankruptcy or other laws, that Fund’s ability to dispose of the underlying securities may be restricted. It is possible, in a bankruptcy or liquidation scenario, that the Fund may not be able to substantiate its interest in the underlying securities. Finally, if a seller defaults on its obligation to repurchase securities under a reverse repurchase agreement, a Fund may suffer a loss to the extent that it is forced to liquidate its position in the market, and proceeds from the sale of the underlying securities are less than the repurchase price agreed to by the defaulting seller.

The financing used by a Fund to leverage its portfolio will be extended by securities broker-dealers or financial institutions in the marketplace in which the Fund invests. While Arrowgrass US will attempt to negotiate the terms of these financing arrangements with such broker-dealers or financial institutions, its ability to do so will be limited. A Fund is therefore subject to changes in the value that the broker-dealer or financial institution ascribes to a given security or position, the amount of margin required to support such security or position, the borrowing rate to finance such security or position and/or such broker-dealer’s or financial institution’s willingness to continue to provide any such credit to a Fund. If a Fund currently has no alternative credit facility which could be used to finance its portfolio in the absence of financing from broker-dealers or financial institutions, it could be forced to liquidate its portfolio on short notice to meet its financing obligations. The forced liquidation of all or a portion of a Fund’s portfolio at distressed prices could result in significant losses to that Fund.

(xv) Certain Derivative Investments.

Arrowgrass US may cause a Fund to buy or sell (write) both call options and put options, and when it writes options, it may do so on a “covered” or an “uncovered” basis. A call option is “covered” when the writer owns securities of the same class and amount as those to which the call option applies. A put option is covered when the writer has an open short position in securities of the relevant class and amount. A Fund’s option transactions may be part of a hedging strategy (*i.e.*, offsetting the risk involved in another security’s position) or a form of leverage, in which that Fund has the right to benefit from price movements in a large number of securities with a small commitment of capital. These activities involve risks that can be substantial, depending on the circumstances.

In general, the principal risks involved in options trading can be described as follows, without taking into account other positions or transactions into which a Fund may enter. When a Fund buys an option, a decrease (or inadequate increase) in the price of the underlying security in the case of a call, or an increase (or inadequate decrease) in the price of the underlying security in the case of a put, could result in a total loss of a Fund’s investment in the option (including commissions). A Fund could mitigate those losses by selling short, or buying puts on, the securities as to which it holds call

options, or by taking a long position (e.g., by buying the securities or buying calls on them) in securities underlying put options.

When a Fund sells (writes) an option, the risk can be substantially greater than when it buys an option. The seller of an uncovered call option bears the risk of an increase in the market price of the underlying security above the exercise price. The risk is theoretically unlimited unless the option is “covered”. If it is covered, a Fund would forego the opportunity for profit on the underlying security should the market price of the security rise above the exercise price. If the price of the underlying security were to drop below the exercise price, the premium received on the option (after transaction costs) would provide profit that would reduce or offset any loss a Fund might suffer as a result of owning the security.

(xvi) Swap Agreements.

A Fund may enter into swap agreements. Swap agreements can be individually negotiated and structured to include exposure to a variety of different types of investments or market factors. Depending on their structure, swap agreements may increase or decrease a Fund’s exposure to long-term or short-term interest rates, currency values, corporate borrowing rates, or other factors such as security prices, baskets of equity securities or inflation rates. Swap agreements can take many different forms and are known by a variety of names. A Fund is not limited to any particular form of swap agreement if consistent with that Fund’s investment objective and approach.

Swap agreements tend to shift a Fund’s investment exposure from one type of investment to another. For example, if a Fund agrees to exchange payments in Sterling for payments in US Dollars, the swap agreement would tend to decrease a Fund’s exposure to United Kingdom interest rates and increase its exposure to non-United Kingdom currency and interest rates. Depending on how they are used, swap agreements may increase or decrease the overall volatility of a Fund’s portfolio. The most significant factor in the performance of swap agreements is the change in the specific interest rate, currency, individual equity values or other factors that determine the amounts of payments due to and from the Fund. If a swap agreement calls for payments by a Fund, that Fund must be prepared to make such payments when due. In addition, if a counterparty’s creditworthiness declines, the value of swap agreements with such counterparty can be expected to decline, potentially resulting in losses by that Fund.

(xvii) Highly Volatile Instruments.

The prices of derivative instruments, including options, are highly volatile. Price movements of forward contracts and other derivative contracts in which a Fund’s assets may be invested are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and national and international political and economic events and policies. In addition, governments from time to time intervene, directly and by regulation, in certain markets, particularly those in currencies and financial instrument options. Such intervention often is intended directly to influence prices and may, together with other factors, cause all of such markets to move rapidly in the same direction because of, among other things, interest rate fluctuations. A Fund also is subject to the risk of the failure of any of the exchanges on which its positions trade or of their clearing houses.

(xviii) Investments in Unlisted Securities.

A Fund may invest in unlisted securities. Because of the absence of any trading market for these investments, it may take longer to liquidate, or it may not be possible to liquidate, these positions

than would be the case for publicly traded securities. Although these securities may be resold in privately negotiated transactions, the prices realized on these sales could be less than those originally paid by a Fund. Further, companies whose securities are not publicly traded will generally not be subject to public disclosure and other investor protection requirements applicable to publicly traded securities.

(xix) Short Selling.

Short selling involves selling securities which are not owned by the short seller and borrowing them for delivery to the purchaser, with an obligation to replace the borrowed securities at a later date. Short selling allows the investor to profit from a decline in market price to the extent such decline exceeds the transaction costs and the costs of borrowing the securities. The extent to which a Fund engages in short sales will depend upon its investment strategy and opportunities. A short sale creates the risk of a theoretically unlimited loss, in that the price of the underlying security could theoretically increase without limit, thus increasing the cost to a Fund of buying those securities to cover the short position. There can be no assurance that the Fund will be able to maintain the ability to borrow securities sold short. In such cases, a Fund can be "bought in" (*i.e.*, forced to repurchase securities in the open market to return to the lender). There also can be no assurance that the securities necessary to cover a short position will be available for purchase at or near prices quoted in the market. Purchasing securities to close out a short position can itself cause the price of the securities to rise further, thereby exacerbating the loss. Legal and regulatory restrictions may impact on the ability of a Fund to sell a security short and/or may require a Fund to disclose any short position with possible adverse consequences to that Fund.

(xx) Futures Contracts.

The value of futures depends upon the price of the financial instruments, or other commodities underlying them. The prices of futures are highly volatile, and price movements of futures contracts can be influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and national and international political and economic events and policies. In addition, investments in futures are also subject to the risk of the failure of any of the exchanges on which the Fund's positions trade or of its clearing houses or counterparties.

Futures positions may be illiquid because certain commodity exchanges limit fluctuations in certain futures contract prices during a single day by regulations referred to as "daily price fluctuation limits" or "daily limits". Under such daily limits, during a single trading day no trades may be executed at prices beyond the daily limits. Once the price of a particular futures contract has increased or decreased by an amount equal to the daily limit, positions in that contract can neither be taken nor liquidated unless traders are willing to effect trades at or within the limit. This could prevent the Fund from promptly liquidating unfavorable positions and subject the Fund to substantial losses or prevent it from entering into desired trades. In extraordinary circumstances, a futures exchange could suspend trading in a particular futures contract, or order liquidation or settlement of all open positions in such contract.

(xxi) Forward Trading.

Forward contracts and options thereon, unlike futures contracts, are not traded on exchanges and are not standardized; rather, banks and dealers act as principals in these markets, negotiating each transaction on an individual basis. Forward and "cash" trading is substantially unregulated; there is no limitation on daily price movements and speculative position limits are not applicable. The

principals who deal in the forward markets are not required to continue to make markets in the currencies or commodities they trade and these markets can experience periods of illiquidity, sometimes of significant duration. There have been periods during which certain participants in these markets have refused to quote prices for certain currencies or commodities or have quoted prices with an unusually wide spread between the price at which they were prepared to buy and that at which they were prepared to sell. Disruptions can occur in any market traded by a Fund due to unusually high trading volume, political intervention or other factors. The imposition of controls by governmental authorities might also limit such forward trading to less than that which Arrowgrass US would otherwise recommend, to the possible detriment of a Fund. Market illiquidity or disruption could result in major losses to a Fund.

(xxii) Hedging Transactions.

A Fund may utilize financial instruments, both for investment purposes and for risk management purposes in order to (i) protect against possible changes in the market value of that Fund's investment portfolio resulting from fluctuations in the securities markets and changes in interest rates; (ii) protect that Fund's unrealized gains in the value of that Fund's investment portfolio; (iii) facilitate the sale of any such investments; (iv) enhance or preserve returns, spreads or gains on any investment in that Fund's portfolio; (v) hedge the interest rate or currency exchange rate on any of that Fund's liabilities or assets; (vi) protect against any increase in the price of any securities that Fund anticipates purchasing at a later date; or (vii) for any other reason that Arrowgrass US deems appropriate.

The success of a Fund's hedging strategy will depend, in part, upon Arrowgrass US's ability correctly to assess the degree of correlation between the performance of the instruments used in the hedging strategy and the performance of the portfolio investments being hedged. Since the characteristics of many securities change as markets change or time passes, the success of a Fund's hedging strategy will also be subject to Arrowgrass US's ability to continually recalculate, readjust and execute hedges in an efficient and timely manner. While a Fund may enter into hedging transactions to seek to reduce risk, such transactions may result in a poorer overall performance for a Fund than if it had not engaged in such hedging transactions. For a variety of reasons, Arrowgrass US may not seek to establish a perfect correlation between the hedging instruments utilized and the portfolio holdings being hedged. Such an imperfect correlation may prevent a Fund from achieving the intended hedge or expose a Fund to risk of loss. Arrowgrass US may not hedge against a particular risk because it does not regard the probability of the risk occurring to be sufficiently high as to justify the cost of the hedge, or because it does not foresee the occurrence of the risk. The successful utilization of hedging and risk management transactions requires skills complementary to those needed in the selection of a Fund's portfolio holdings.

(xxiii) Highly Volatile Markets.

The prices of financial instruments in which a Fund may invest can be highly volatile. Price movements of forward and other derivative contracts in which a Fund's assets may be invested are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and national and international political and economic events and policies. A Fund is subject to the risk of failure of any of the exchanges on which its positions trade or of its clearinghouses.

(xxiv) Exchange Rate Fluctuations; Currency Considerations.

A Fund's assets will often be invested in securities denominated in other currencies than that Fund's base currency and any income or capital received by the Fund will be denominated in the local currency of investment. Accordingly, changes in currency exchange rates (to the extent unhedged) will affect the value of a Fund's portfolio and the unrealized appreciation or depreciation of investments.

Furthermore, a Fund may incur costs in connection with conversions between various currencies. Currency exchange dealers realise a profit based on the difference between the prices at which they are buying and selling various currencies. Thus, a dealer normally will offer to sell currency to a Fund at one rate, while offering a lesser rate of exchange should the Fund desire immediately to resell that currency to the dealer. A Fund will conduct its currency exchange transactions either on a spot (i.e., cash) basis at the spot rate prevailing in the currency exchange market, or through entering into forward or options contracts to purchase or sell currencies.

(xxv) Loans of Portfolio Securities.

A Fund may lend its portfolio securities. By doing so, a Fund attempts to increase income through the receipt of interest on the loan. In the event of the bankruptcy of the other party to a securities loan, a Fund could experience delays in recovering the loaned securities. To the extent that the value of the securities a Fund lent has increased, that Fund could experience a loss if such securities are not recovered.

(xxvi) Certain Securities Markets.

Stock markets in certain countries may have a relatively low volume of trading. Securities of companies in such markets may also be less liquid and more volatile than securities of comparable companies elsewhere. There may be low levels of government regulation of stock exchanges, brokers and listed companies in certain countries. In addition, settlement of trades in some markets is slow and subject to failure.

Some commodity exchanges are "principals' markets" in which performance is the responsibility only of the individual member with whom the trader has entered into a commodity contract and not of an exchange or clearing corporation. In such a case, a Fund is subject to the risk of the inability of, or refusal by, the counterparty to perform with respect to such contracts. In addition, the trading of futures and forward contracts on certain commodity exchanges may be subject to price fluctuation limits.

(xxvii) Emerging Markets.

Funds may invest in markets worldwide, including, without limitation, many developing markets in Asia, Latin America, emerging Europe and Africa. Investment in emerging market securities involves a greater degree of risk than an investment in securities of issuers based in developed countries. Among other things, emerging market securities investments may be subject to the following risks: less publicly available information; more volatile markets; less liquidity or available credit; political or economic instability; less strict securities market regulation; less favorable tax or legal provisions; price controls and other restrictive governmental actions; a greater likelihood of severe inflation; unstable currency; and war and expropriation of personal property.

Emerging markets generally are not as efficient as those in developed countries. In some cases, a market for the security may not exist locally and transactions will need to be made on a neighboring exchange. Volume and liquidity levels in emerging markets are lower than in developed countries. When seeking to sell emerging market securities, little or no market may exist for the securities. In addition, issuers based in emerging markets are not generally subject to uniform accounting and financial reporting standards, practices and requirements comparable to those applicable to issuers based in developed countries, thereby potentially increasing the risk of fraud or other deceptive practices. The quality and reliability of official data published by the government or securities exchanges in emerging markets may not accurately reflect the actual circumstances being reported. The issuers of some securities, such as banks and other financial institutions, may be subject to less stringent regulations than would be the case for issuers in developed countries and, therefore, potentially carry greater risk. In addition, a Fund's investment opportunities in certain emerging markets may be restricted by legal limits on foreign investment in local securities or restrictions on the ability to convert currency or to take currencies out of certain countries.

Due to the foregoing risks and complications, the costs associated with investments in emerging market securities generally are higher than for securities of issuers based in developed countries. In addition, economic problems in a single emerging market country are increasingly affecting other markets and economies. A continuation of this trend could adversely affect global economic conditions and world markets and, in turn, could adversely affect a Fund's performance.

(xxviii) Counterparty Risk.

Some of the markets in which a Fund may effect transactions are "over-the-counter" or "interdealer" markets. The participants in such markets are typically not subject to credit evaluation and regulatory oversight as are members of "exchange-based" markets. This exposes that Fund to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a dispute over the terms of the contract (whether or not *bona fide*) or because of a credit or liquidity problem, thus causing that Fund to suffer a loss. Such "counterparty risk" is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where a Fund has concentrated its transactions with a single or small group of counterparties. The Funds are not restricted from dealing with any particular counterparty or from concentrating any or all of its transactions with one counterparty. Moreover, a Fund has no internal credit function which evaluates the creditworthiness of its counterparties. The ability of the Funds to transact business with any one or number of counterparties, the lack of any independent evaluation of such counterparties' financial capabilities and the absence of a regulated market to facilitate settlement may increase the potential for losses by a Fund.

Whenever a Fund obtains leverage by entering into a derivative transaction with a financial institution pursuant to which the Fund does not own any underlying investments in its own name but instead has the right to receive a return based on the performance of the investment, that Fund will have only a derivative interest in the performance of the portfolio. This may limit that Fund's right to pursue contractual and other rights and claims against the entities in which it invests and, in certain circumstances, against the directors, trading advisors and administrators of such entities.

The stability and liquidity of repurchase agreements, swap transactions, forward transactions and other OTC derivative transactions depend in large part on the creditworthiness of the parties to the transactions. If there is a default by the counterparty to such a transaction, a Fund will under most normal circumstances have contractual remedies pursuant to the agreements related to the transaction. However, exercising such contractual rights may involve delays or costs which could result in the net asset value of that Fund being less than if it had not entered into the transaction.

Furthermore, there is a risk that any of such counterparties could become insolvent. If one or more of a Fund's counterparties were to become insolvent or the subject of liquidation proceedings in the United States (either under the Securities Investor Protection Act or the United States Bankruptcy Code), there exists the risk that the recovery of that Fund's securities and other assets from such prime broker or broker-dealer will be delayed, possibly for a number of years, or be of a value significantly less than the value of the securities or assets originally entrusted to such prime broker or broker-dealer.

In addition, a Fund may use counterparties located in various jurisdictions outside the United States. Such local counterparties are subject to various laws and regulations in various jurisdictions that are designed to protect their customers in the event of their insolvency. However, the practical effect of these laws and their application to a Fund's assets are subject to substantial limitations and uncertainties. Because of the large number of entities and jurisdictions involved and the range of possible factual scenarios involving the insolvency of a counterparty, it is impossible to generalize about the effect of their insolvency on a Fund and its assets. Clients should assume that the insolvency of any counterparty would result in a loss to the relevant Fund, which could be material.

(xxix) Credit Default Swaps.

A Fund may invest in credit default swaps. Credit default swaps can be used to implement Arrowgrass US's view that a particular credit, or group of credits, will experience credit improvement or deterioration. In the case of expected credit improvement, a Fund may sell credit default protection in which it receives a premium to take on the risk. In such an instance, the obligation of the Fund to make payments upon the occurrence of a credit event creates leveraged exposure to the credit risk of the referenced entity. A Fund may also buy credit default protection with respect to a reference entity if, in the judgment of Arrowgrass US, there is a high likelihood of credit deterioration. In such instance, a Fund will pay a premium regardless of whether there is a credit event. The credit default swap market in high yield securities is comparatively new and rapidly evolving compared to the credit default swap market for more seasoned and liquid investment-grade securities creating the risk that the newer markets will be less liquid, making it potentially more difficult to exit or enter into a particular transaction.

(xxx) Collateral.

A Fund will have significant credit and operational risk exposure to its counterparties, which will require that Fund to post collateral to support its obligations in connection with transactions involving forwards, swaps, futures, options, and other derivative instruments. Generally, counterparties will have the right to sell, pledge, rehypothecate, assign, use or otherwise dispose of the collateral posted by the Fund in connection with such transactions. This could increase a Fund's exposure to the risk of a counterparty default since, under such circumstances, such collateral of that Fund could be lost or that Fund may be unable to recover such collateral promptly. Also, counterparties have an interest in maximizing the return from such collateral. This interest could conflict with the interests of a Fund in preserving and protecting its portfolio.



**ITEM 9**  
**DISCIPLINARY INFORMATION**

There are no legal or disciplinary events that are material to a client's or prospective client's evaluation of Arrowgrass US's advisory business or the integrity of Arrowgrass US's management.

**ITEM 10**  
**OTHER FINANCIAL ACTIVITIES AND AFFILIATIONS**

Broker-Dealer Registration Status

Arrowgrass US and its management persons are not registered as broker-dealers and do not have any application pending to register with the SEC as a broker-dealer or registered representative of a broker-dealer.

Futures Commission Merchant, Commodity Pool Operator or Commodity Trading Advisor Registration Status

Arrowgrass US and its management persons are not registered as, and do not have any application to register as, futures commission merchants, commodity pool operators, commodity trading advisors or associated persons of the foregoing entities.

Material Relationships or Arrangements with Industry Participants and Material Conflicts of Interest Relating to Other Investment Advisers

Arrowgrass US does not recommend or select other investment advisers for its clients. However, Arrowgrass US is appointed alongside Arrowgrass UK to serve jointly as investment advisers to the Funds. Arrowgrass US and Arrowgrass UK both receive a share of management fees and incentive fees from the Manager for services to the Funds.

A Fund may, subject to its investment restrictions, invest seed or initial capital in another Fund and generally the investing Fund will not pay management or incentive fees in respect of such investment. Such seed capital may be significant and the investing Fund may agree that it will not withdraw it for a specified period of time. Arrowgrass US will seek to manage any conflicts arising as a result thereof, bearing in mind its obligations to both of the relevant Funds.

Deutsche Bank AG, London Branch (“Deutsche Bank”) has a minority economic interest in Arrowgrass US, Arrowgrass UK and the Manager. Deutsche Bank will not be involved in the investment management activities or other ordinary business of Arrowgrass US, Arrowgrass UK or the Manager but will have the right to consent to certain corporate actions to protect its minority interest.

Without limiting the generality of the foregoing, Deutsche Bank AG, London Branch, Deutsche Bank Securities Inc. or any of their affiliates (collectively and individually, “DB Prime Broker”) may act as a prime broker, may provide financing to a Fund or may stand as a counterparty to any of its transactions. In undertaking any such role, DB Prime Broker may provide securities brokerage, foreign exchange, banking and other services or may act as principal, on usual terms and may benefit therefrom.

Subject to the foregoing, and to any restrictions adopted by a Fund’s directors, Arrowgrass US or DB Prime Broker, and any directors of the foregoing, may (a) have an interest in a Fund or in any transaction effected with or for it, or a relationship of any description with any other person, which may involve a potential conflict with their respective duties to a Fund, and (b) deal with or otherwise use the services of DB Prime Broker in connection with the performance of such duties.

Potential conflicts may arise because: (a) DB Prime Broker undertakes business for other clients; (b) DB Prime Broker’s directors or employees are directors of, hold or deal in securities of, or are

otherwise interested in, any company the securities of which are held by or dealt in on behalf of a Fund; (c) the transaction relates to an investment in respect of which DB Prime Broker may benefit from a commission, fee, mark-up or mark-down payable otherwise than by a Fund; (d) DB Prime Broker may act as agent for a Fund in relation to transactions in which it is also acting as agent for the account of a client of Deutsche Bank; (e) DB Prime Broker may deal in investments and/or currencies as principal with a Fund or any of the Fund's shareholders; (f) the transaction is in units or shares of a collective investment scheme or any company of which DB Prime Broker is the manager, operator, banker, adviser or trustee; (g) DB Prime Broker may effect transactions for a Fund involving placing with another Deutsche Bank entity which may be acting as principal or receiving agent's commission; or (h) DB Prime Broker may have taken a position, as principal either for its own account or for its clients in the markets and instruments in respect of which it is providing investment advice to a Fund.

It is the policy of Arrowgrass US to meet the highest standards of ethical and market practice in respect of the management of conflicts of interest and to act at all times in the best interests of its clients. In that regard, Arrowgrass US has put in place a conflicts of interests policy with set practices and procedures that it follows. Where possible, Arrowgrass US seeks to organize its business activities, including external arrangements, so as to avoid conflicts. Where conflicts are unavoidable, it ensure appropriate policies, procedures and controls are developed ahead of the arrangement giving rise to such conflicts.

Where Arrowgrass US is not reasonably confident that the interests of a client will be adequately protected, it will clearly disclose the general nature and/or sources of conflicts of interest to a client which will enable the client to take an informed decision with respect to the service in respect of which the conflict arises. Please see Item 11 for a further description of the conflicts of interest practices and procedures employed by Arrowgrass US.

Arrowgrass US's choice of brokers is subject to a best execution policy, which sets forth the criteria considered when Arrowgrass US selects a broker-dealer for execution, as further described in Item 12 below.

**ITEM 11**  
**CODE OF ETHICS, PARTICIPATION OR**  
**INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING**

Code of Ethics

As part of its commitment to honesty, integrity and professionalism, Arrowgrass US has adopted a Code of Ethics (the “Code”). The Code incorporates the following general principles, which all Arrowgrass US employees are expected to uphold:

- Arrowgrass US must at all times place the interests of its clients first.
- All personal securities transactions must be conducted in a manner consistent with the Code and a personal account dealing policy adopted by Arrowgrass US.
- Employees must not take any inappropriate advantage of their positions at Arrowgrass US.
- Information concerning the identity and financial circumstances of its clients and their investors must be kept confidential.
- Independence in the investment decision-making process must be maintained at all times.

Arrowgrass US permits employees to acquire or sell, for their personal accounts, securities that may also be held, purchased or sold, for the accounts of Arrowgrass clients. Arrowgrass' Code places restrictions on Arrowgrass employee trading to ensure that personal investing activity of Arrowgrass employees is consistent with Arrowgrass' fiduciary duty to its clients. Generally, the Code requires that employees pre-clear all personal transactions with the Arrowgrass compliance department before effecting a personal transaction in securities, except for a limited number of exempt and permitted transactions, including, but not limited to, shares of open-ended mutual funds, US Government securities, and exchange traded funds (“ETFs”) and options that are well diversified or based on broad based indices or commodities. The Code also imposes certain lockout periods whereby employees may not be able to trade in a particular security if Arrowgrass is recommending a transaction in that security for clients. Arrowgrass employees are required to disclose their personal securities holdings and transactions to the Arrowgrass compliance department on a periodic basis. Clients, investors or prospective investors may obtain a copy of the Code by contacting Arrowgrass' Chief Compliance Officer.

Cross-Trades. A transfer from one Fund to one or more other Funds (a “Cross-Trade”) may be effected where Arrowgrass US determines that the relevant transaction is in the best interests (and consistent with the investment program, risk management and other relevant considerations) of the relevant Funds and where such transaction will assist Arrowgrass US to adhere to its policies and procedures, subject to compliance with applicable regulatory rules. In a Cross-Trade, the relevant asset will be transferred at a price that reflects the fair value of the security on the date it is transacted *i.e.* the same price that would be paid or received if the transaction was traded with a knowledgeable third party at arm’s length. Cross-Trades will be disclosed to the Funds and best execution obtained. Neither Arrowgrass US nor any related party will receive any compensation in connection with a Cross-Trade.

Allocation Policy. Participation in specific investment opportunities may be appropriate, at times, for more than one Fund. In such cases, where possible, participation in such opportunities will be allocated on a fair and equitable basis taking into account various factors for the relevant Funds including, without limitation, the relative amounts of capital available for new investments, existing portfolio positions, the Funds’ respective investment programs and restrictions, regulatory or tax

restrictions, relative exposure to short-term market trends, whether positions are being made to hedge macro exposures, risk capacity, liquidity concerns and the ability to split trades. Such considerations may result in allocations of certain investments on other than a *pari passu* basis. An allocation committee has been established which meets periodically in order to review and monitor the allocation process and implementation of the allocation rules applicable to Arrowgrass US.

Order Aggregation. Arrowgrass US may execute trades in respect of each of its Funds on an aggregated basis. The decision to aggregate will be determined by the structure of the product in question and the associated trade costs of the transaction in question. Arrowgrass US will not aggregate orders unless aggregation is consistent with its duty to obtain best execution and no Fund will be favored over any other Fund. Where the market convention for that product allows, each Fund that participates in an aggregated order will participate at the average price for each of the relevant transactions (whereby sale orders placed during a trading day on behalf of such Funds are combined, and securities bought and sold pursuant to such orders are allocated among such Funds on an average price basis). Otherwise, a fair and equitable allocation will be performed to ensure that no Fund is systematically disadvantaged.

## **ITEM 12**

### **BROKERAGE PRACTICES**

Arrowgrass US has a duty to obtain best execution for its clients and to comply with such duty it has adopted a best execution policy, which sets forth the criteria considered when Arrowgrass US selects a broker-dealer for execution, and a dealing commissions and soft dollar policy, which sets forth the controls in place around the accrual and use of soft dollars. Such policies are summarized below.

Arrowgrass US utilizes various brokers and dealers to execute securities transactions. Portfolio transactions for the Funds will be allocated to broker-dealers based on a number of factors, including (among other things) commissions/price, the ability of the broker-dealers to effect the transactions, the broker-dealers' facilities, research capabilities, reliability and financial responsibility. The broker-dealer may use part of the relevant commission to pay for certain services related to the execution of transactions on behalf of clients and/or the provision of investment research to Arrowgrass US.

Arrowgrass US has in place commission sharing agreements with various broker-dealers. It is intended that such arrangements will assist Arrowgrass US in the provision of investment management services to the Funds. These arrangements include both proprietary research from analysts employed by broker-dealers and other trading counterparties as well as independent research obtained from external specialist providers.

Subject to the rules of the SEC and FSA, Arrowgrass US may agree that a broker-dealer shall be paid a commission exceeding the amount another broker-dealer would have charged for the same transaction if, in the good faith judgement of Arrowgrass US, the amount of the commission is reasonable in relation to the value of the brokerage and other services provided or paid for by such broker-dealer.

When Arrowgrass US uses client brokerage commissions (or markups or markdowns) to obtain research or other products or services, Arrowgrass US receives a benefit because it does not have to produce or pay for such products or services. Such arrangements pose a conflict of interest as they may incentivize Arrowgrass US to favor certain broker-dealers based not on the quality of their execution and competitive commission rates but rather on the ancillary research services that Arrowgrass US receives.

To address this conflict, Arrowgrass US has adopted a dealing commission and soft dollar policy. Consistent with this policy, Arrowgrass US may only use these dealing commission credits (or "soft dollars") to pay for goods or services that:

- Are related to the execution of trades on behalf of the Funds; or
- Comprise the provision of research; and
- Will reasonably assist Arrowgrass US in the provision of its services to the Funds on whose behalf the orders are being executed; and
- Are not likely to impair the compliance with Arrowgrass' duty to act in the best interests of the Funds.

Arrowgrass US will also operate, to the extent applicable, within the safe harbor created by section 28(e) of the US Securities Exchange Act of 1934, as amended. Soft dollars generated in respect of futures, currency and derivatives transactions and principal transactions (that are not riskless principal transactions) that do not generally fall within the safe harbor created by Section 28(e) will

be utilized only with respect to research-related products and services for the benefit of the relevant Funds.

Consistent with Section 28(e), research products or services obtained with “soft dollars” generated by one or more Funds may be used by Arrowgrass to service one or more other Funds, including Funds that may not have paid for the soft dollar benefits. Arrowgrass does not seek to allocate soft dollar benefits to client accounts in proportion to the soft dollar credits the client accounts generate.

Within Arrowgrass' last fiscal year, Arrowgrass or its related persons acquired the following types of products and services with client brokerage commissions (or markups or markdowns):

- Research from independent analysts specializing in a particular market sector or jurisdiction including proprietary and analytical intelligence on matters such as liquidity events in the equity and distressed markets.
- Research services from analysts with Broker Dealers, including the provision of technical research on market and stock behavior.
- Independent expert guidance through an approved expert network provider.
- Analytical tools built by providers to assist with the timing of market entry and exit, identification of price trends and market direction.

Arrowgrass makes annual disclosure to the Funds of the goods and services provided to the Funds that are in relation to the execution of trades and/or the provision of research.

Arrowgrass has entered into agreements on behalf of its Funds with certain broker-dealers that act as prime brokers and/or custodians on behalf of the Funds. The Funds are not committed to continue their relationship with such prime brokers and custodians for any minimum period, and Arrowgrass, in its discretion, may select other or additional brokers to act as prime broker(s) or custodian(s) for the Funds.

From time to time, Arrowgrass personnel may speak at conferences or programs for potential investors interested in investing in hedge funds which are sponsored by the Funds' prime brokers. Through such "capital introduction" events, prospective investors in the Funds have the opportunity to meet with Arrowgrass. Neither Arrowgrass nor the Funds compensate the prime brokers for organizing such events or for investments ultimately made by prospective investors attending such events. However, such events and other services (including, without limitation, capital introduction services) provided by the prime brokers may influence Arrowgrass in deciding whether to use such prime broker in connection with brokerage, financing and other activities of the Funds.

Subject to best execution, Arrowgrass US may consider, among other things, capital introduction services provided by broker-dealers in directing Fund brokerage business.

Arrowgrass US does not permit any directed brokerage arrangements at this time. Directed brokerage refers to instances in which a client retains the discretion to choose brokers and instructs Arrowgrass US to direct portfolio transactions to a particular broker-dealer.

Please see Item 11 above for a summary of Arrowgrass US's policy on order aggregation.

### **ITEM 13**

#### **REVIEW OF ACCOUNTS**

Arrowgrass' portfolio managers engage in ongoing monitoring of each investment on a daily basis.

Arrowgrass' operations also reviews the transactions entered into for Funds to ensure that correct entries have been made for all Fund records on a daily basis.

Arrowgrass holds daily risk meetings where the focus is on day to day movements in the Funds' risk exposures and on external events.

In addition, the Chief Investment Officer in respect of each Fund conducts periodic reviews of that Fund's portfolios to ensure that investments are being made in accordance with the investment objectives and guidelines as set forth in their respective offering memoranda and constituent documents. Further, the Chief Investment Officer discusses with portfolio managers and analysts key risk issues and individual portfolio managers are asked to explain performance and outline their individual investment views.

On a monthly basis the Chief Executive Officer, in his capacity as the Chief Risk Officer, chairs a monthly risk committee meeting for each Fund which discusses issues such as a Fund's previous month's performance including realized and unrealized gains and losses on a month-to-date and year-to-date basis.

Among the above deliberations, decisions on asset allocation are made, dealing errors, if any, are reviewed and strategic proposals are reviewed.

In addition to the above risk-based review, a review of a Fund account by the Chief Compliance Officer may be triggered by any unusual activity or special circumstances.

Arrowgrass will provide the Funds and investors in each Fund with annual audited financial statements for the applicable Fund within 120 days' of the Fund's fiscal year-end.

Investors in the Funds receive a monthly letter from Arrowgrass setting forth the estimated performance of their Fund, along with a commentary by Arrowgrass, although Arrowgrass may provide certain investors with information on a more frequent and detailed basis if agreed to by Arrowgrass. Information also may be available through Arrowgrass' password-protected website. In addition, Arrowgrass issues investors tax reports and audited financial statements concerning their respective Funds within 120 days of the Fund's fiscal year-end.



**ITEM 14**  
**CLIENT REFERRALS AND OTHER COMPENSATION**

Arrowgrass US does not generally receive economic benefits from non-clients for providing investment advice and other advisory services.

Neither Arrowgrass US nor any related person directly or indirectly compensates any person who is not a supervised person, including placement agents, for client referrals.

## **ITEM 15**

### **CUSTODY**

Rule 206(4)-2 under the Advisers Act (and certain related rules and regulations under the Advisers Act) imposes certain obligations on registered investment advisers that have custody or possession of any funds or securities in which any client has any beneficial interest ("Custody Rule"). An investment adviser is deemed to have custody or possession of client funds or securities if the adviser directly or indirectly holds client funds or securities or has the authority to obtain possession of them.

An adviser has custody if it (or in some circumstances an affiliate) acts in any capacity that gives the adviser (or, as pertinent, the affiliate) legal ownership of, or access to, funds or securities of the adviser's clients. Accordingly, Arrowgrass is deemed to have custody of Fund assets. Therefore, Arrowgrass is required to maintain the funds and securities over which it has custody with a "qualified custodian." Qualified custodians include banks, broker-dealers, futures commission merchants and certain foreign financial institutions.

Additionally, the Custody Rule imposes on advisers with custody of client assets certain reporting requirements to such clients. However, Arrowgrass is not required to comply (or is deemed to have complied) with the reporting requirements of the Custody Rule with respect to each Fund because it complies with the provisions of the so-called "Pooled Vehicle Annual Audit Exception", which, among other things, requires that each Fund be subject to audit at least annually by an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board, and requires that each Fund distribute its audited financial statements to all investors within 120 days of the end of its fiscal year.

Arrowgrass US intends to distribute the audited financials of each Fund to Fund Investors within the 120-day time period according to the requirements of this exception and therefore will be exempt from the Custody Rule reporting requirements with respect to the Funds.

**ITEM 16**  
**INVESTMENT DISCRETION**

Arrowgrass US has full discretionary authority with respect to investment decisions for each Fund under the terms of an investment management agreement or similar agreement with each Fund. Arrowgrass US provides investment advice to Funds in accordance with the investment objectives and guidelines set forth in their respective offering documents.

**ITEM 17**  
**VOTING OF CLIENT SECURITIES**

Arrowgrass has authority to vote proxies on behalf of its clients, the Funds, and has established procedures as guidance thereon. In compliance with Advisers Act Rule 206(4)-6, Arrowgrass has adopted proxy voting policies and procedures to mitigate any potential conflicts of interest that may arise when voting proxies on behalf of the Funds. The general policy is to vote proxy proposals, amendments, consents or resolutions (collectively, "Proxies") in a manner that Arrowgrass determines will serve the applicable Fund's best interests and is in line with each Fund's investment objectives. Arrowgrass has set up structural procedures to ensure that all proxies that are received are properly distributed and taken care of on a timely basis. After a careful analysis and a determination is made how to vote, an authorized individual will then submit the proxy vote. Once the proxy has been voted, it will be recorded and stored by Arrowgrass.

Arrowgrass understands the importance of voting proxies and will seek in all cases to vote proxies in the best interest of its clients. In limited circumstances, Arrowgrass may abstain from voting or affirmatively decide not to vote if it determines that this is in the best interest of its Funds. In making such a determination, various factors are considered including, a Fund's current position in the proxy issuer, any costs associated with the exercise of the proxy and any legal restrictions on trading resulting from the exercise of a proxy.

Conflicts of interest may arise between the interests of the Funds on the one hand and Arrowgrass US or its affiliates on the other hand. If Arrowgrass US determines that it may have, or is perceived to have, a conflict of interest when voting Proxies, Arrowgrass US will vote in accordance with its Proxy voting policies and procedures. A copy of Arrowgrass' Proxy Voting Policies and Procedures may be obtained by contacting Arrowgrass' Chief Compliance Officer. Clients may also request a record of how proxies have been voted on their behalf.

**ITEM 18**  
**FINANCIAL INFORMATION**

Arrowgrass US is not required to include a balance sheet for its most recent fiscal year, is not aware of any financial condition reasonably likely to impair its ability to meet contractual commitments to clients, and has not been the subject of a bankruptcy petition at any time during the past ten years.