



VARDEN PACIFIC LP

201 Mission Street, Suite 2230
San Francisco, California 94105

(415) 835-3880
www.vardenpacific.com

FORM ADV PART 2

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This brochure provides information about the qualifications and business practices of Varden Pacific LP. If you have any questions about the contents of this brochure, please contact us at (415) 835-3880. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the “SEC”) or by any state securities authority.

Additional information about Varden Pacific LP is available on the SEC’s website at www.adviserinfo.sec.gov.

Item 2 – Material Changes

Since the annual filing of this brochure on March 30, 2020, there have been no material changes to this brochure except to note in Item 8, “*Methods of Analysis, Investment Strategies and Risk of Loss – Risks Associated with Our Investment Strategy and Techniques*” that from March 2020 to date we have exercised our right to suspend withdrawals/redemptions from our funds due to the unprecedented levels of volatility and reduced liquidity in the market attributable to the global health pandemic.

Because this Item 2 discusses only those changes to this brochure that have been made since March 30, 2020 that the firm believes to be material, this brochure should be reviewed in its entirety.

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Item 4 – Advisory Business

Structure; History and Ownership

Varden Pacific LP is an investment advisory firm with its principal place of business in San Francisco, California. Varden Pacific LP will be referred to in this brochure as “Varden,” “the firm,” “we” or “us.” Varden commenced business in 2010.

This brochure provides information about the firm, its clients and certain of Varden’s affiliates.

The firm has four employees. The general partner of the firm is Varden Pacific General Partner II LLC, a Delaware limited liability company. In addition, the firm’s principal direct and indirect owners, Dennis Lin, Brad Scelfo and Shawn Stoval, are involved in the firm’s day-to-day management. The firm was founded by Dennis Lin, Brad Scelfo, and Shawn Stoval. Dennis Lin serves as the firm’s chief compliance officer (the “CCO”).

The firm and its affiliates have formed Varden Pacific Opportunity Partners I LP (the “Onshore Fund”) and Varden Pacific Opportunity Offshore Fund I Ltd. (the “Offshore Fund”), each of which was organized for the primary purpose of investing in Varden Pacific Opportunity Partners I Master (Cayman) Unit Trust, an open-ended exempted unit trust established under the Trusts Law (Revised) of the Cayman Islands by declaration of trust dated December 1, 2010 (the “Master Fund” and, together with the Onshore Fund, the Offshore Fund and any additional pooled investment vehicles sponsored by Varden or its affiliates, the “Funds”). The Onshore Fund and the Master Fund were launched together in April 2011; the Offshore Fund was launched in May 2012. Varden has been delegated responsibility for investment management of the Funds and has full discretionary authority and responsibility over the Funds’ investments.

The firm is registered as a commodity pool operator with the Commodity Futures Trading Commission (the “CFTC”) and is a member of the National Futures Association (the “NFA”). Although the firm is registered as a commodity pool operator with the CFTC and a member of the NFA, the Funds will be treated as “exempt pools” within the meaning of CFTC Rule 4.7 promulgated under the Commodity Exchange Act, as amended (the “Commodity Exchange Act”). Accordingly, the firm will operate under an exemption from certain recordkeeping, reporting and other provisions of the Commodity Exchange Act and the regulations thereunder that would otherwise apply to the firm with respect to the Funds.

The Offshore Fund has engaged two independent directors, Julie Hughes and Padraig Hoare. As a result, a majority of the board of directors of the Offshore Fund is comprised of independent directors.

Types of Advisory Services

Varden provides discretionary investment advisory services to the Funds and may provide discretionary and/or non-discretionary investment advisory services to separate accounts. Investments in the Funds are only offered to institutional and high net worth investors through private placements. Full descriptions of the Funds’ investment objectives and strategies, as well as risk factors pertaining to an investment in the Funds, are set forth in the Funds’ Confidential Offering and Explanatory Memoranda, copies of which will be delivered to qualifying prospective investors. Separate accounts are governed by investment advisory agreements between us and the separate account.

The Funds are managed in accordance with their own investment guidelines and are not tailored to any particular investor’s needs, nor are the Funds’ investors permitted to impose restrictions on the Funds’ investments. Investors in separate accounts may have greater flexibility in directing the investment strategy and guidelines applicable to their investments. Although the Funds and any separate accounts may

generally hold the same securities, a separate account may vary greatly in terms of concentration and turn-over as directed by its owner or determined by us.

Assets Under Management

As of December 31, 2020, we managed approximately \$412,940,175 in “regulatory assets under management,” on a discretionary basis as reported in Item 5.F. in Part 1A of the firm’s Form ADV.

Item 5 – Fees and Compensation

Fees

We are generally entitled to receive a management fee in consideration of the management and administrative services we provide to the Funds. The management fee we receive from the Funds is payable quarterly in advance and is equal to 0.4375% (or 1.75% on an annualized basis) of the net asset value of the Funds excluding the allocable share attributable to the firm and its affiliates. The management fees are charged on a *pro rata* basis to each investor, other than such investors, if any, as we may designate. We may agree to different fee terms with respect to separate accounts.

We are entitled to receive performance-based compensation from the Funds equal to 20% of the net profits (including realized and unrealized profits and losses) allocated to each investor in the Funds for each six-calendar month period above a “high-watermark” (*i.e.*, any prior losses allocated to an investor in respect of such investment must be recouped before we may receive any performance-based compensation in respect of such investor). The performance-based compensation we receive from the Funds is calculated separately with respect to each investment by each investor. In addition, each investment in the Funds is subject to recurring, successive 18-month lock-up periods (each 18-month lock-up period, a “lock-up period”). The performance-based compensation amount with respect to the final six-calendar month period in the initial lock-up period applicable to such investment will be reduced if the aggregate performance-based compensation made with respect to such investment for the six-calendar month periods from the date of investment through the end of the initial applicable lock-up period exceeds a hypothetical single performance-based compensation amount calculated using the entire period from the date of investment through the end of the initial lock-up period applicable to such investment (any such reduction, a “clawback”). Performance-based compensation charged to a separate account is negotiated with respect to a separate account individually.

Expenses

Each Fund shall bear all operating expense and other costs incurred by such Fund including, but not limited to:

- accounting, bookkeeping and auditing fees and expenses (including the allocable share of the costs, fees and expenses relating to internal accounting and tax preparation functions – inclusive of salaries of any personnel of the firm or any affiliate performing such functions – should the firm or an affiliate determine not to use third-party providers for such services);
- legal fees and expenses, including, but not limited to, fees and expenses incurred in connection with the confidential private offering memorandum of the Fund and/or the partnership agreement of the Fund, any offering of interests in the Fund (including, without limitation, negotiations and agreements with current and prospective investors), fund contracts and investments;

- all fees and disbursements of the Fund's, the firm's and their affiliates' attorneys, consultants and other third parties performing work benefiting such Fund (including, without limitation, administrator fees, custodian fees, trustee fees, the legal and other fees, costs and expenses of the Fund in any threatened or actual litigation or governmental investigation or proceeding, and the amount of any judgments or settlements paid in connection with such litigation or fines or penalties levied as a result of any such proceeding or investigation);
- insurance and bonding costs;
- all trading expenses and transaction costs, including, but not limited to, brokerage commissions and expenses relating to short sales, clearing and settlement charges, interest on loans and debit balances, margin interest, broker service fees and other clearing and custodial expenses;
- fees or assessments in connection with any regulatory registrations, qualifications and/or approvals of the Fund, the firm or an affiliate, and related compliance fees and expenses, deemed appropriate by the firm or its affiliate;
- such research and portfolio management expenses as the firm or an affiliate deems appropriate, which may include, but are not limited to, expenses incurred in connection with due diligence investigations or research as to investments or potential investments, including travel, lodging and other expenses incurred in connection with visits to companies, meetings, research symposiums and communications with company management, security holders, analysts and other third parties, costs of research reports, data feeds and databases, data loading and cleansing software, Bloomberg terminals, Reuters feeds or similar, news wires and quotation services, periodical subscription fees and costs of software (including risk control and market analytic software) utilized by the firm or an affiliate in connection with managing the Fund's portfolio;
- fees of the Fund's registered agent;
- the cost of preparation and distribution of reports and statements to investors;
- all filing and recording fees;
- all custodial fees, bank service fees, and fees or expenses associated with insuring the Fund's assets,
- the management fee; and
- all applicable federal, state, local and foreign taxes payable by the Fund.

Each Fund's investors shall bear these fees on a *pro rata* basis. In addition, the Onshore Fund and Offshore Fund, as unitholders of the Master Fund, indirectly bear their ratable portion of the costs and expenses of the Master Fund described above.

Expenses incurred in the organization of the Funds were borne or reimbursed by the Funds. As unitholders of the Master Fund, the Onshore Fund and the Offshore Fund indirectly bear a ratable portion of the organizational expenses of the Master Fund. We generally bear our own expenses (aside from customary trade execution and settlement expenses) in connection with providing advice to a separate account.

Item 6 – Performance-Based Fees and Side-by-Side Management

As noted in Item 5, we receive performance-based compensation from our clients. The rates at which we receive performance-based compensation may vary from client to client. As a result, we may have a conflict of interest, because we can potentially receive proportionately greater compensation from those clients subject to higher performance based compensation rates than those subject to lower rates. We have an incentive to:

- direct the best investment ideas or give favorable allocation to those clients that are subject to higher performance-based compensation rates;
- use trades by a client that is not subject to any performance-based compensation or is subject to lower performance-based compensation rates to benefit those clients that are subject to higher performance-based compensation rates, such as where a Fund sells short before a sale by a separate account that is subject to a lower performance-based compensation rate, or a Fund sells a security only after a separate account that is subject to a lower performance-based compensation rate has made a large purchase of the security; and
- benefit those clients subject to a higher performance-based compensation rate over those clients subject to a lower performance-based compensation rate which have a different and potentially conflicting investment strategy.

We owe a fiduciary duty to our clients not to favor one client over another, without regard to the types and amounts of fees paid by those clients. In light of the possible conflicts of interest described above, we have allocation policies and procedures in place to ensure that each of our clients is treated fairly. Where we determine to trade for more than one client in the same instruments, we generally aggregate the trades and cause the accounts to trade *pari passu* with each other. However, while clients may trade the same and/or similar instruments, some may be distinguished from one another by their investment objectives, investment methodology, fee terms or other investment or trading parameters. Accordingly, we may cause purchases or sales to be effected for one client while not causing such purchases or sales to be effected for another client. We may determine also to use substantially different degrees of leverage in certain clients' accounts when effecting a transaction, when maintaining a position, or in conducting investment activities generally. Discretion as to which clients will receive allocations of particular positions may be exercised whether investment opportunities are limited or unlimited, and opportunities to participate in transactions may not necessarily be allocated among our clients in any particular proportion.

If multiple clients qualify for participation in the purchase of a specific security or investment opportunity by such portfolio group, we will endeavor to allocate the instruments among the clients for which the instrument or investment opportunity is appropriate, on a fair and equitable basis. Common trades on the same day among clients are generally allocated on the basis of the relative assets committed to the strategy at the average price per share among such clients. While no client will be given investment priority over any other client, each client may have separate investment objectives and investment restrictions which we are required to follow; as a result, certain investment opportunities may be appropriate for certain clients and not for others. We apply such considerations as we deem appropriate, including:

- relative size of such entities,
- amount of available capital,
- size of existing positions in the same or similar securities,
- leverage, and

- tax considerations and other factors.

Nevertheless, prospective investors should understand that we may have an incentive to favor certain clients over others.

Item 7 – Types of Clients

We generally provide investment advice to two types of clients: unregistered investment vehicles (such as the Funds) and the holders of separate accounts. Our separate account clients and the investors in the Funds may include high net worth individuals and a variety of institutional investors, including private funds of funds, trusts, employee benefit plans, foundations, endowments, corporations, banks, thrifts, sovereign wealth funds, and other types of entities meeting the terms of the exceptions and exemptions under which the Funds operate and wishing to invest in accordance with the Funds' investment objectives. U.S. investors in the Offshore Fund and all investors in the Onshore Fund must be "accredited investors" under the Securities Act of 1933 (the "Securities Act"), "qualified purchasers" under the Investment Company Act of 1940, and "qualified eligible persons" under the Commodity Exchange Act. Our separate account clients may be subject to similar regulatory qualifications.

The Funds have a minimum initial investment amount of \$5,000,000, a requirement which may be waived subject to applicable law and our discretion. Additional contributions, in minimum amounts of \$250,000 unless waived, may be made at the beginning of a month or at other times as we may permit. Separate accounts may have minimums prescribed by their investment advisory agreements.

Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss

Investment Objective and Strategy

For a more complete description of the Funds' investment objective and strategy, please see the relevant Fund's Confidential Offering or Explanatory Memorandum.

The firm's strategy is to capitalize on market dislocations in corporate credit resulting from changes in regulatory capital rules for banks. Post the implementation of Dodd Frank legislation, certain product lines for banks became more expensive to manage due to the increase in regulatory capital requirements stemming from this legislation. As a result, banks are now forced to more actively manage their capital requirements to maximize profitability of these product lines. This management of regulatory capital requirements is achieved primarily through two channels: 1) selling assets that are capital inefficient, and 2) facilitating risk transfer trades to reduce their overall regulatory capital requirements for the product line. The firm believes this forced transfer of risk causes dislocations in pricing with few buyers to absorb the supply and high barriers to entry. This is the area the firm attempts to exploit.

Our investment thesis of capitalizing on dislocations in corporate credit has remained consistent since our Funds' April 2011 launch. Our execution on this thesis, however, has evolved over time. Between 2011 and early 2013, the firm's primary focus was on purchasing legacy assets created between 2005-2008 for banks and insurance companies in order to achieve the highest return for a given credit rating. Changes in rating agency methodology and increased conservatism on the side of regulatory capital and accounting bodies post-crisis forced many original holders to sell these assets into a market with few buyers. This was an area Varden Pacific capitalized. For the last six years, however, much of the firm's risk has been acquired on a negotiated basis with the broker-dealers who originally created these legacy assets. Post implementation of Dodd Frank legislation, these broker-dealers now face more restrictive regulatory capital rules forcing them to shed risk in order to better manage regulatory capital requirements. While our underlying thesis remains the same, the structure of the risk is now predominately different.

Our investment objective is to generate attractive long-term risk-adjusted returns by capitalizing on dislocations created by this forced transfer of risk. Our investment team collaborates to identify opportunities in primarily corporate credit markets by leveraging product expertise and strong industry relationships. While the firm currently focuses on investing the majority of the Funds' assets in corporate credit and structured corporate credit products, we also look across fixed income markets for investment opportunities. These may include, among others, emerging markets, interest rates, government and agency bonds, municipal bonds, currencies, and commodities and index or index like instruments (e.g., exchange traded funds) that reference related risks. A significant portion of the Funds' investments are purchased in non-US markets. Leverage can be obtained by borrowing against the Funds' assets and, synthetically, through investments in swaps, derivatives, structured products, options and/or futures.

Our core investment strategy emphasizes the following products and strategies:

Corporate Credit and Structured Finance Products. The majority of the Funds' capital is currently invested in corporate credit and corporate credit-backed structured finance products. This risk can be conveyed in both funded (cash) or unfunded (derivative) form. Corporate credit investments are made in bonds, loans, and credit derivatives, and other products transferring credit risk, which exposes the Funds to risk associated with corporate defaults and correlated defaults, recovery, curve shape, credit spread movements and interest rate risk. Certain of such securities and other instruments may be unrated and, whether or not rated, may have speculative characteristics. A structured finance product often takes the form of a security, or derivative, backed by a pool of bonds, loans and other assets including synthetic risk exposures. Structured finance products may be backed by corporate bonds, commercial loans, asset-backed securities, residential mortgage-backed securities, commercial mortgage-backed securities, emerging market debt, sovereign debt, credit default swaps, interest rate swaps, options or other assets. Structured finance securities or derivatives are typically characterized by classes, or tranches, that define their risk and return profiles. Typical structured finance products are structured in a way that enables the most senior tranche to withstand elevated default scenarios before becoming impaired, and hence modest return; the most junior tranche has more credit risk and hence higher returns. Thus, if a default occurs in the assets or synthetic reference assets backing a structured finance product, the senior bond classes are most insulated from this default, while the most junior class, which is known as the equity tranche, will likely experience some degree of loss. The Funds may invest in any tranches structured finance products. The investment characteristics of some structured finance products may differ from traditional debt securities. Among the major differences are some structured finance products include embedded structural leverage which can amplify both gains and losses, as well a financial leverage, which also amplifies both gains and losses.

Hedging. We may, but are not required to, employ a variety of hedging techniques. Such techniques are intended to limit the Funds' exposure to risks. Hedging may involve a variety of instruments and strategies, including selling short securities believed to be likely to decline in price, taking offsetting or partially offsetting positions in swaps, options, futures or other derivatives or cash products, or investing in or shorting market index or "market basket" instruments. At times, all or a substantial portion of the portfolio of the Funds may be un-hedged. Hedging may decrease the return on investment in the Funds.

Leverage. We may utilize borrowed funds or utilize swaps, options, futures, or other derivatives for investing or hedging purposes. These activities may incur leverage in their investment or hedging activities on behalf of the Funds. The use of leverage can increase investment returns, as well as the risk of investment loss and associated volatility. Leverage employed for hedging may decrease the return on investment in the Funds. Borrowed funds may be used both for short-term objectives, such as for purposes of making timely investments or facilitating the payment of withdrawal proceeds, as well as for long-term leveraging purposes, where borrowed funds may be applied to increase the Funds' capital available for investment. The Funds may also use leverage to enhance investment returns.

Short Selling. We may from time to time engage in short sale transactions in which we will sell securities we do not own (but have borrowed) in anticipation of a decline in the market price of the securities or for hedging purposes. Short selling may decrease the return on our investment if the asset price rises.

Restricted Securities. We invest in so-called “Restricted Securities,” *i.e.*, securities as to which the public resale is currently restricted under the Securities Act, and which are not immediately convertible into freely tradable securities. We intend to purchase Restricted Securities where characteristics of such securities justify the limited liquidity. The exit strategy for Restricted Securities is either holding the instrument to maturity, in the case of a security with a maturity date, or waiting for conditions that provide the means of achieving marketability, such as the availability of a secondary market, registration rights under the Securities Act or the right to convert into marketable securities.

Foreign Issuers. We invest in the securities of foreign issuers, including both those traded overseas as well as those traded in the United States.

Cash Positions. We hold or invest in cash, U.S. government securities, commercial obligations, bankers’ acceptances, certificates of deposits, money-market instruments and other cash equivalents. Accordingly, the Funds may not be fully invested at all times.

Options. We purchase or write call and put options on swaps, options, futures, securities, securities indices or groups of securities that are traded on U.S. or non-U.S. securities exchanges or sold over-the-counter. We also buy or sell put and call options on currencies or other instruments. Options written (sold) by the firm may be covered (*i.e.*, where the Funds own an offsetting position in the underlying security) or uncovered.

Swaps, Forwards, Indices and Other Derivatives. We utilize various types of swaps (including but not limited to credit default swaps and total rate of return swaps), spot or forward contracts, indices and other derivatives, including with respect to commodities or currencies, in furtherance of their objectives. Such instruments are generally illiquid with no trading market.

U.S. Treasury Bills and other Government Securities. We may invest in government bonds issued by the United States Department of the Treasury through the Bureau of the Public Debt.

Municipal Securities. We may invest in municipal bonds issued by one or more cities or other local governments and agencies, including, but not limited to, counties, redevelopment agencies, special-purpose districts, school districts, publicly owned airports and seaports and any other governmental entities below the state level, in order to take advantage of fixed and/or variable interest rates and possible exemptions granted to holders of municipal bonds on interest received with respect to federal income tax and income tax of the state in which the municipal bonds originate.

Stock Index Options. We may also purchase and sell call and put options on stock indices listed on securities exchanges or traded in the over-the-counter market for the purpose of realizing our investment objectives or for the purpose of hedging our portfolio.

ETFs. We may also invest in ETFs, or exchange traded funds, which are publicly traded investment vehicles that hold passively managed portfolios of stocks.

In addition to our core investment strategy, we may make any other investments or employ any other investment strategies that we deem appropriate and may invest in and trade a variety of securities and instruments.

Investment Philosophy

Our investment team (the “Portfolio Managers”) believe that the following factors, among others, have created attractive investment opportunities for investment managers with the necessary experience and the technical expertise to capitalize on them:

- The last twenty years saw a rapid proliferation of products in fixed income, including credit derivatives, bonds, loans, structured products, securitizations, swaps, options and futures, among others.
- Changes in the regulatory landscape have created an incentive for broker/dealers to transfer risk off of their balance sheets in order to become more regulatory capital efficient.
- Demand for such securities or risk transfer may be limited due to, among other reasons, a lack of product expertise, liquidity and price volatility concerns, negative perceptions of structural complexity, regulatory and accounting changes.

Investment Approach

Our competitive advantage is our expertise in structured or derivative-based assets within fixed income and our ability to identify opportunities and risk manage these investments. We employ a “top down/bottom up” analysis of potential investments. Investment ideas are generated using a top down approach to sector and asset class analysis, including collaborative discussion of economic and political environments, market conditions and current research. Investment ideas are verified, and investment decisions made, using a bottom up approach to analyzing individual assets, including (as a general matter): credit risk analysis; recovery analysis; documentation analysis; quantitative analysis and trade modeling; risk neutral pricing; assessment of legal and compliance concerns; assessment of the liquidity of individual investments; calculation of risk/return profiles, comparison to other known investment opportunities; and assessment of investments as they relate to our strategy and market views.

Risks Associated with Our Investment Strategy and Techniques

Our methods of minimizing the risks associated with our investment strategy and techniques may not accurately predict future risk exposures. Risk management techniques are based in part on the observation of historical market behavior, which may not predict market divergences that are larger or more frequent than historical indicators. Information used to manage risks may not be accurate, complete or current, and such information may be misinterpreted. Further, we may apply such risk management techniques on a selective or other periodic basis rather than at all times.

For a more complete summary of the risks inherent in an investment in the Funds, please see the relevant Fund’s Confidential Offering or Explanatory Memorandum.

Limited Prior Application of Investment Strategy. While we have experience dealing with the products that we invest in, we have only implemented our investment strategy with respect to the Funds for a limited amount of time. Past performance of any methodology should not be considered as assuring any given future results. Accordingly, there can be no assurance that our investment strategy and approach will prove successful when applied in the context of the Funds and over time under various market conditions and events.

Dependence Upon Portfolio Managers. Our success critically depends upon the efforts of Messrs. Stoval, Scelfo and Lin as Portfolio Managers. In the event that Messrs. Stoval, Scelfo and/or Lin cease to be responsible for the Funds’ investments for any reason, and although other investment personnel may be

available, the operations of the Funds could be adversely affected. Messrs. Stoval, Scelfo and/or Lin may have significant business responsibilities in addition to those of the Funds and any separate accounts including, without limitation, the management of other investment vehicles and accounts.

Substantial Withdrawals/Redemptions. Substantial withdrawals or redemptions by investors within a short period of time could require the firm to arrange for the Funds' positions to be liquidated more rapidly than would otherwise be desirable, which could (i) adversely affect the value of the remaining equity interests in the Funds; (ii) cause the Funds to utilize leverage in order to satisfy withdrawal or redemption requests, which would likely cause the remaining investors to bear the costs of such leverage; or (iii) result in the firm choosing to terminate the Funds. We have the right to suspend withdrawals/redemptions or to delay any withdrawal or redemption payment if we determine that the liquidation of investments necessary to fund such withdrawal or redemption would be detrimental to the remaining investors, and we have exercised that right to suspend withdrawals/redemptions from March 2020 to date due to the unprecedented levels of volatility and reduced liquidity in the market attributable to the global health pandemic. In addition, regardless of the period of time in which withdrawals or redemptions occur, the resulting reduction in the Funds' assets could make it more difficult to generate positive returns or recoup losses due to a reduced equity base.

Valuation Risk. The net asset value of the Funds is generally calculated by an administrator based on prices it calculates itself or obtains from the firm, derivative counterparties, broker/dealers and/or independent third-party sources including exchanges. The fair market value of those assets of the Funds for which a third-party price is not available, or with respect to which the firm believes third-party pricing does not accurately reflect fair value, is valued based on other sources deemed reliable by the firm, and may be based on internal valuation analysis, such as a discounted cash-flow valuation. Investors should note that there is a risk that an investor that makes a withdrawal from the Funds may be paid an amount less or more than it would otherwise be paid if the actual value of such assets is higher or lower than the value calculated by the Funds' administrator. In addition, there is a risk that additional contributions could dilute the underlying value of such assets for the other investors if the actual value of such assets is higher than the value calculated by the Funds' administrator. There is also a risk that greater management fees and incentive fees or allocations may be paid or allocated by the Funds than would have been paid if the actual value of such assets or liabilities is lower or higher than the value determined for the purposes of calculating those fees and allocations. The firm is not liable to the Funds if a price reasonably believed by it to be an accurate valuation of a particular asset of the Funds is found not to be such.

Furthermore, in the event the firm is provided with, or otherwise comes into possession of, information which leads the firm to determine that one or more valuations of Funds' assets for a prior period are inaccurate, the firm may adjust or amend such prior valuations as the firm deems appropriate, and to adjust or amend any reports or statements of the Funds (whether or not previously issued) with respect to such prior periods. There is no guarantee that the value determined by the firm represents the value that will be realized by the firm on the eventual disposition of the investment or that would, in fact, be realized upon an immediate disposition of the investment.

Because the firm receives compensation based on the performance of the investments of the Funds, there is an inherent conflict of interest.

Achievement of Our Investment Objective and Strategies. No assurance can be given that we will achieve our overall investment objective. There can be no assurance that we will be able to allocate the Funds' assets in a manner that is profitable. Additionally, the profitability of a significant portion of the Funds' investment program depends to a great extent on correct assessments of the future course of the price movements of securities and other investments. There can be no assurance that the firm will be able to accurately predict such price movements. The securities markets have in recent years been characterized

by volatility and unpredictability. In addition to market risk, there is unpredictability as to changes in general economic conditions, which may affect the profitability of the Funds' investment program. With respect to the investment strategies utilized by the firm, there is always some, and often a significant, degree of market risk.

Institutional Risk. The institutions, including the brokerage firms, banks, and custodians with which the Funds (directly or indirectly) do business, or to which securities have been entrusted for custodial and prime brokerage purposes, may encounter financial difficulties that impair the operational capabilities or the capital position of the Funds. In the event of financial distress of an aforementioned entity, it is possible the Funds' assets could become part of the insolvent entity's assets, to the detriment of the Funds. Brokers may trade with an exchange as a principal on behalf of the Funds in a "debtor-creditor" relationship, unlike other clearing broker relationships where the broker is merely a facilitator of the transaction. Such brokers could, therefore, have title to all of the assets of the Funds (for example, the transactions which the broker has entered into on behalf of the Funds as principal as well as the margin payments which the Funds provide). In the event of such a broker's insolvency, the transactions which the broker has entered into as principal could default and the Funds' assets could become part of the insolvent broker's assets, to the detriment of the Funds. In this regard, assets may be held in "street name" such that a default by the broker may cause the Funds' rights to be limited to that of an unsecured creditor.

Under CFTC regulations, commodity brokers are required to maintain customers' assets in a segregated account. If a commodity broker engaged by the firm with respect to the Funds fails to do so, the Funds may be subject to a risk of loss of the funds on deposit with the commodity broker in the event of the commodity broker's bankruptcy. In addition, under certain circumstances, such as the inability of another customer of the commodity broker or the commodity broker itself to satisfy substantial deficiencies in such other customer's account, the Funds may be subject to a risk of loss of the funds on deposit with its commodity broker(s). In the case of any such bankruptcy or customer loss, the Funds might recover, even in respect of property specifically traceable to it, only a *pro rata* share of all property available for distribution to all the commodity broker's customers.

Counterparty Risk. We may execute transactions through OTC or "interdealer" markets, or through a clearing house or exchange, among others. The participants in such markets are typically not subject to credit evaluation and regulatory oversight as are members of "exchange based" markets. We may also enter into other contract arrangements that expose the Funds to the creditworthiness and performance of one or more counterparties. This exposes the Funds 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 the Funds to suffer a loss. Such "counterparty risk" is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where the Funds have 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. Although the Funds intend to enter into transactions only with counterparties that the firm believes to be creditworthy and may attempt to reduce its exposure by obtaining collateral in appropriate cases, there can be no assurance that a counterparty will not default and that the Funds will not sustain a loss on a transaction as a result. In addition, concentration of transactions with a limited number of counterparties could increase the potential for losses by the Funds. The ability of the Funds to transact business with any one or number of counterparties, the lack of any meaningful and independent evaluation of such counterparties' financial capabilities and the absence of a regulated market to facilitate settlement may increase the potential for losses by the Funds.

The assets of the Funds may be held by non-United States brokers, custodians or any other entities or counterparties of the Funds (including, but not limited to, sub-custodians). Such assets of the Funds may be available to the creditors of those non-United States brokers, entities and counterparties. These

relationships expose the Funds to credit risks and involve the risk that the counterparties may become insolvent.

Because securities of the Funds held by broker-dealers are generally not held in the Master Fund's name, a failure of a broker-dealer may have a greater adverse impact on the Funds than if such securities were registered in the Master Fund's name.

Cyber Security Risks. As part of our business, we process, store and transmit large amounts of electronic information, including information relating to the transactions of the Funds and personally identifiable information of the investors in such Funds. Similarly, service providers of the firm and the Funds, especially the Funds' administrator, may process, store and transmit such information. With the increased use of technologies such as the Internet and the dependence on computer systems to perform necessary business functions, investment vehicles, such as the Funds, and their services providers may be prone to operational and information security risks resulting from cyber-attacks. In general, cyber-attacks result from deliberate attacks, but unintentional events may have effects similar to those caused by cyber-attacks. Cyber-attacks include, among other behaviors, stealing or corrupting data maintained online or digitally, denial-of-service attacks on websites, the unauthorized release of confidential information and causing operational disruption.

We have procedures and systems in place that we believe are reasonably designed to protect such information and prevent data loss and security breaches. However, such procedures cannot provide absolute security. The techniques used to obtain unauthorized access to data, disable or degrade service, or sabotage systems change frequently and may be difficult to detect for long periods of time. Hardware or software acquired from third parties may contain defects in design or manufacture. Network connected services provided by third parties to the Funds may be susceptible to compromise, leading to a breach of the Funds' network. The Funds' systems or facilities may be susceptible to employee error or malfeasance, government surveillance or other security threats. On-line services provided by the Funds, or any of their service providers, to the investors in the Funds may also be susceptible to compromise. Breach of the firm's or the Funds' information systems may cause information relating to the transactions of the Funds and personally identifiable information of the investors in the Funds to be lost or improperly accessed, used or disclosed.

Cyber-attacks may interfere with the processing of investor transactions, impact the Funds' ability to value its assets, cause the release of personally identifiable information of the investors in the Funds or confidential information of the Funds or impede trading. Further, the loss of, improper access to, or improper disclosure of, the firm's proprietary information may cause the firm to suffer, among other things, financial loss, the disruption of its businesses, liability to third parties, regulatory intervention, fines, penalties, financial losses, reimbursement or other compensation costs, additional compliance costs or reputational damage. Any of the foregoing events could have a material adverse effect on the Funds and the investors' investments therein.

Alternative Investing Generally. The Funds are designed for investors seeking potential long-term growth from alternative investments, who do not require regular current income and who can accept a high degree of risk in their investments. In view of, among other things, the Funds' ability to invest in a wide range of securities and instruments and to use a broad variety of investment techniques, the Funds may be deemed speculative in nature and is not intended to be a comprehensive investment program. The Funds are intended for investment solely by sophisticated investors who are accustomed to and fully understand the risks of such investments.

Risks of Investments in Securities Generally. Our investment program may at times involve, without limitation, risks associated with limited diversification, leverage, credit, interest rates, currencies,

correlation, volatility, liquidity, tracking risks in hedged positions, security borrowing risks in short sales, credit deterioration or default risks, recovery risks, collateral risks, mark-to-market risk, margin call risk, counterparty default risks, systems risks and other risks inherent in our investment activities. Certain investment techniques of the Funds can, in certain circumstances, magnify the impact of adverse market moves to which the Funds may be subject. In addition, the Funds' investments in securities and other investments may be materially affected by conditions in the financial markets and overall economic conditions occurring globally and in particular countries or markets where the Funds may invest their capital.

Our methods of minimizing such risks may not accurately predict future risk exposures. Risk management techniques are based in part on the observation of historical market behavior, which may not predict market divergences that are larger or more frequent than historical indicators. Information used to manage risks may not be accurate, complete or current, and such information may be misinterpreted. Further, we may apply such risk management techniques on a selective or other periodic basis rather than at all times.

Concentration of Investments. We do not apply fixed diversification standards to the Funds' portfolio with respect to any particular industries, industry sectors or types or securities. In addition, the Funds' investment strategy contemplates investing primarily in a limited number of types of securities. Thus, at any given time the Funds' portfolio may be concentrated, to varying degrees, within one or more security types. Any such concentration can increase significantly both investment risk and portfolio volatility.

Structured Finance Products. A majority of the Funds' capital is currently invested in corporate credit-backed structured finance products, in both funded (cash) and unfunded (derivative) form. Some structured finance products are subject to credit, liquidity, default, recovery, correlation, market value, margin posting, interest rate, currency, sovereign, collateral, operations, structural, legal, tax and certain other risks. Structured finance products are generally privately placed and offer less liquidity than other investment grade or non-investment grade corporate debt. As they are issued as structured finance transactions, they also have risks that may be different from regular corporate debt. In addition, concentrations of structured finance products of a particular type, as well as concentrations of structured finance products issued or guaranteed by affiliated obligors, serviced by the same servicer or backed by the same or similar underlying collateral, may subject the Funds to additional risk. A portion of the Funds' portfolio may consist of structured finance products that are subordinate in right of payment and rank junior to other securities that are secured by, or represent an ownership interest in, the same pool of assets. In addition, certain transactions have structural features that may divert payments of interest and/or principal to more senior classes when the delinquency or loss experience of the pool exceeds certain levels. As a result, such securities have a higher risk of loss as a result of increased losses in the underlying pool of assets. In certain circumstances, payments of interest may be reduced or eliminated for one or more payment dates, and/or principal payment may be reduced or eliminated.

Price Volatility. The securities to be invested in by the Funds are inherently volatile. Such volatility may result in the value of the Funds' assets fluctuating from time-to-time more greatly than that of other investment vehicles which may be more widely diversified or which may invest in a greater variety of geographic or market sectors. There can be no assurance that the firm's investment strategy, including its possible hedging techniques, or other investment strategies or techniques, will be effective in protecting the Funds from such price volatility. In addition, price volatility could require the Funds to post collateral with certain counterparties. If the Funds cannot post the required collateral, the Funds could be involuntarily forced out of positions, resulting in losses for the Funds.

Restricted Securities and Other Illiquid Investments. We may invest in non-public and restricted securities and other assets, which are subject to legal or other restrictions on transfer or for which no liquid market exists. The market prices, if any, for such investments tend to be volatile and may not be readily

ascertainable, and we may not be able to sell them when we desire to do so or to realize what we perceive to be their fair value in the event of a sale. The sale of restricted and illiquid securities often requires more time and results in higher brokerage charges or dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in the over-the-counter markets. The Funds 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. Restricted securities may sell at a price lower than similar securities that are not subject to restrictions on resale. Disposition of such investments may be possible, if at all, only at substantial discounts from their purchase price or intrinsic value. Substantial holdings by the Funds of illiquid securities may adversely affect the ability of the Funds to effect capital withdrawals on a satisfactory basis.

Equity Risks. We may invest in equity and equity derivative securities, including exchange traded funds, index based products and options. The value of these securities generally will vary with the performance of the issuer and movements in the equity markets. As a result, the Funds may suffer losses if they invest in equity securities of issuers whose performance diverges from the firm's expectations or if equity markets generally move in a single direction and the Funds have not hedged against such a general move. To the extent the Funds invest in equity derivatives and private placements activities, the Funds are exposed to risks that issuers will not fulfill their contractual obligations to the Funds, such as delivering marketable common stocks upon conversions of convertible securities and registering restricted securities for public resale.

Debt Securities. We invest in debt securities and instruments including derivatives, swaps, options and futures. Certain of the debt instruments in which the Funds invest may be unrated, and whether or not rated, the debt instrument may have speculative characteristics. The issuers of such instruments may face significant ongoing uncertainties and exposure to adverse conditions that may undermine the issuer's ability to make timely payment of interest and principal. In addition, an economic recession could severely disrupt the market for these securities and may have an adverse impact on the value of such instruments. It is also 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.

Forwards, Swaps, Repos and Other Derivatives. We may utilize forwards, swap contracts, repurchase agreements ("repos") and other over-the-counter derivative instruments. Principal risks relating to the use of derivatives include, in the case of hedging strategies, the possible imperfect correlation between the derivative and the market value of the securities, currencies or other commodity position intended to be hedged (*i.e.*, tracking risk); losses magnified by the degree of leverage (exposure) represented by the derivative; lack of a liquid secondary market for closing out the position; losses resulting from interest rate or currency movements not anticipated by the firm; reduced returns as a result of collateral posting to counterparties; margin call risk whereby the Funds must post collateral or be closed out of a position; and the risk of counterparty default.

A position in a derivative instrument entails risks that are separate and distinct from those of the underlying interest. For example, the leverage (market risk per trading unit) and volatility represented by a derivative instrument is often significantly greater than that of the underlying interest. When traded in markets, derivative trading is often more volatile and less regulated than trading in established debt or equity issues. Trading in various over-the-counter derivatives, moreover, involves certain risks as to the counterparty (*i.e.*, its ability to fulfill its contractual obligations under the derivative instrument). The derivatives markets are frequently characterized by limited liquidity, which can make it difficult as well as costly to close out open positions in order to either realize gains or to limit losses. Additionally, many derivatives are valued on the basis of dealers' pricing of these instruments. However, the price at which dealers value a particular derivative and the price which the same dealers would actually be willing to pay for such derivative should the Funds be required to sell such position, may be materially different. Such differences can result in an

overstatement of the Funds' net asset value, and may have a material adverse effect on the Funds if they are required to sell derivative instruments in order to raise funds for margin purposes or to pay withdrawals or redemptions.

The pricing relationships between derivatives and the underlying instruments on which they are based may not conform to anticipated or historical patterns, resulting in unanticipated losses. In addition, there may be an imperfect correlation between the derivative and the market value of the securities, currencies or other commodity position intended to be hedged.

The stability and liquidity of forwards, swaps, repurchase agreements and other over-the-counter derivative transactions depend in large part on the creditworthiness of the parties to the transaction. If there is a default by the counterparty to a transaction, the Funds may have contractual remedies pursuant to the agreements related to the transaction; however, exercising such contractual rights may involve delays or costs, or may not be successful, which could adversely affect the Funds. It is possible that in the event of a counterparty credit default, the Funds may not be able to recover all or a portion of its investment in such derivative instrument and may be exposed to additional liability (*i.e.*, the obligations associated with what has become an unhedged position).

Futures Contracts. Futures contract trading is typically accompanied by a high degree of leverage as, in the futures markets, initial margin deposits are typically low relative to the value of the futures contracts purchased or sold. Low margin deposits mean that a relatively small price movement in a futures contract may result in immediate and substantial losses to the investor. For example, if at the time of purchase 10% of the price of a futures contract is deposited as margin, a 10% decrease in the price of the futures contract would, if the contract is then closed out, result in a total loss of the margin deposit before any deduction for the brokerage commission and other transaction costs. Thus, like other leveraged investments, any purchase or sale of a commodity contract may result in losses in excess of the amount invested.

Futures positions may be illiquid because, for example, some U.S. 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." When such rules are invoked once the price of a particular futures contract has increased or decreased by an amount equal to the daily limit, positions in such futures contract can neither be taken nor liquidated unless traders are willing to effect trades at or within the limit. Futures contract prices in various commodities occasionally have moved the daily limit for several consecutive days with little or no trading. Similar occurrences could prevent us from promptly liquidating unfavorable positions and subject the Funds to substantial losses. In addition, the firm may not be able to execute futures contract trades at favorable prices if trading volume in such contracts is low. It is also possible that an exchange or the CFTC may suspend trading in a particular contract, order immediate liquidation and settlement of a particular contract or order that trading in a particular contract be conducted for liquidation only. The CFTC and certain commodity exchanges have also established limits referred to as speculative position limits, or position limits, on the maximum net long or net short position which any person or group of persons may hold or control in particular futures and options. Limits on trading in options contracts also have been established by the various options exchanges. It is possible that the trading decisions of the firm may have to be modified and that positions held by the Funds may have to be liquidated in order to avoid exceeding any of such limits. Such modification or liquidation, if required, could adversely affect the operations and profitability of the Funds.

Commodities. Trading in commodity interests may involve substantial risks. Commodity markets are highly volatile. The low margin or premiums normally required in such trading may provide a large amount of leverage, and a relatively small change in the price of a security or contract can produce a disproportionately larger profit or loss. There is no assurance that a liquid secondary market will exist for commodity futures contracts or options purchased or sold, and the Funds may be required to maintain a

position until exercise or expiration, which could result in losses. As noted above, many commodity exchanges limit the amount of fluctuation permitted in contract prices during a single trading day. Once the daily limit has been reached in a particular contract, no trades may be made that day at a price beyond that limit. Contract prices could move to the daily limit for several consecutive trading days with little or no trading, thereby preventing prompt liquidation of commodity interest positions and potentially subjecting the Funds (and, as a result, the Funds) to substantial losses. In addition, trading commodity interests on foreign markets may involve greater risk than trading on United States exchanges. For example, some foreign exchanges are principal markets so that no common clearing facility exists and a trader may look only to the broker for performance of the contract. Investing in commodities and forward or futures contracts is a highly specialized investment activity entailing greater than ordinary investment risk.

Currencies. Some investments may be denominated in foreign currencies. This creates currency risk which may or may not be hedged.

The market for a particular forward currency contract held by the Funds may be limited. Trading in the foreign currency exchange market is speculative and volatile; should interest or exchange rates move in an unexpected manner, the Funds may not achieve the anticipated benefits of forward currency contracts or could realize losses. Forward currency contracts are generally not subject to daily price fluctuation limits so that adverse market movements could continue with respect to those contracts to an unlimited extent over a period of time.

Our ability to dispose of the Funds' positions in forward currency contracts will depend on the availability of active markets in those instruments. As a result, no assurance can be given that the firm will be able to utilize these contracts effectively for the purposes described above. Forward currency contracts can expose the Funds to unlimited liability due to the volatility of the currency markets and the leverage factors associated with the contracts.

We may invest on behalf of the Funds in contracts denominated in one currency while distributions, if any, and withdrawals will be made in another currency. A change in the value of one currency with respect to another currency such as the U.S. Dollar, for example, will result in a corresponding change in the U.S. Dollar value of the Funds' assets denominated in those currencies. Foreign currency exchange rates are determined by forces of supply and demand in foreign exchange markets. These forces are, in turn, affected by international balance of payments and other economic and financial conditions, government intervention, speculation and other factors. Foreign currency exchange rates may also be affected by affirmative government policies of intervention in the foreign exchange markets, and certain currencies may be affirmatively supported relative to the dollar by their or other governments. Changes in government policy, including a cessation of currency support intervention, may result in abrupt devaluations of such currencies.

Non-U.S. Investments. We may invest in non-U.S. markets or industries, in instruments that contain embedded non-US exposures such as but not limited to foreign corporate or sovereign risks, or in securities denominated in foreign currencies and/or traded outside of the United States or comparable Western nations. Such investments require consideration of certain risks typically not associated with investing in U.S. securities. Such risks include, among other things, trade balances and imbalances and related economic policies; unfavorable currency exchange rate fluctuations; imposition of exchange control regulation; withholding taxes; interest rate, currency, default, moratorium, repudiation and recovery risks; limitations on the removal of funds or other assets; policies of governments with respect to possible nationalization of their industries; political difficulties, including expropriation of assets, confiscatory taxation; and economic or political instability in foreign nations.

There may be less publicly available information about certain foreign issuers than would be the case for comparable issuers in the United States and certain foreign issuers may not be subject to accounting, auditing and financial reporting standards and requirements comparable to or as uniform as those of United States issuers. Securities markets outside the United States, while growing in volume, have for the most part substantially less volume than U.S. markets, and many securities and other instruments traded on these foreign markets are less liquid and their prices more volatile than securities and other instruments of comparable U.S. issuers. In addition, settlement of trades in some non U.S. markets is slower, less systematic and more subject to failure than in U.S. markets. There also may be less extensive regulation of the securities markets in countries other than the United States.

Additional costs could be incurred in connection with international investment activities. Foreign brokerage commissions generally are higher than in the United States. Expenses also may be incurred on currency exchanges when the firm effectively shifts the Funds' investments from one country, or group of countries, to others. Increased custodian costs as well as administrative difficulties (such as the applicability of foreign laws to foreign custodians in various circumstances, including bankruptcy, ability to recover lost assets, expropriation, nationalization and record access) may be associated with the maintenance of assets in foreign jurisdictions.

Investments in Emerging Markets. We may invest in so-called emerging markets or less developed countries ("EMCs"). It is possible, therefore, that some of the Funds' investments may be in countries characterized by less stable economic or political conditions than in the largest mature Western economies. Emerging market investing is generally characterized as having higher levels of risk than investing in fully developed markets.

EMC investing involves certain considerations not usually associated with investing in securities of developed countries or of companies located in developed countries, including political and economic considerations such as: repudiation and moratorium risks; interest rate, inflation and currency risks; greater risks of expropriation, nationalization and general social, political and economic instability; the small size of the securities markets in such countries; the low volume of trading, resulting in potential lack of liquidity and in price volatility; fluctuations in the rate of exchange between currencies and costs associated with currency conversion; certain government policies affecting investment; and issues as to the orderly clearance and settlement of trades. In addition, accounting and financial reporting standards that prevail in certain of such countries generally are not equivalent to standards in more developed countries. There is also generally less regulation of the securities markets in EMCs than there is in more developed countries. Placing securities with a custodian in EMCs may also present considerable risks. In recent periods, EMC investors, particularly in Russia, Eastern Europe and the Far East, have experienced substantial losses, due in part to debt defaults, political turbulence and economic instability, which factors may be expected to continue.

Short Selling. Selling securities short creates the risk of losing an amount greater than the initial investment in a relatively short period of time and the theoretically unlimited risk of an increase in the market price of the securities sold short. Short selling can also involve significant borrowing and other costs which can reduce the profit or create losses in particular positions. Short selling, particularly in the case of thinly traded or speculative securities, can involve the further risk of an inability to locate or purchase adequate amounts of the security sold short in order to cover the short position. Although the firm may utilize short selling as a hedging technique, short selling may also be used for speculative purposes.

Options. Options positions may include both long positions, where the Funds are the holder of put, call, payer, or receiver options, as well as short positions, where the Funds are the seller (writer) of an option. Although option techniques can increase investment return, they can also involve a relatively higher level of risk. The writing (selling) of uncovered options involves a theoretically unlimited risk of a price increase

or decline, as the case may be, in the underlying security. The expiration of unexercised long option positions effectively results in loss of the entire cost or premium paid for the option. Option premium costs, as well as the cost of covering options written by the Funds, can reduce or eliminate position profits or create losses as well. The Funds' ability to close out its position as a purchaser of an exchange listed option is dependent upon the existence of a liquid secondary market on option exchanges.

The seller ("writer") of a call or receiver option that is covered assumes the risk of a decline in the market price of the underlying security or other instrument below the purchase price of the underlying instrument, less the amount of premium received by the seller, and forgoes the opportunity for gain on the underlying instrument above the exercise price of the option. The seller of an uncovered call or receiver option assumes the risk of a theoretically unlimited increase in the market price of the underlying instrument above the exercise price of the option. The buyer of a call or receiver option assumes the risk of losing its entire investment (the premium paid) in the call option. If the buyer of a call or receiver option sells short the underlying security or other instrument, a loss on the call option itself may be offset, in whole or in part, by any gain on the short sale of the underlying position.

The seller ("writer") of a put or payer option that is covered assumes the risk of an increase in the market price of the underlying security or other instrument above the sales price (in establishing the short position) of the underlying instrument, plus the premium received by the seller, and foregoes the opportunity for gain on the underlying instrument below the exercise price of the option. The seller of an uncovered put or payer option assumes the risk of a decline in the market price of the underlying instrument below the exercise price of the option. The buyer of a put or payer option assumes the risk of losing its entire investment (the premium paid) in the put option. If the buyer of a put option holds a long position in the underlying security or other instrument, a loss on the put option itself may be offset, in whole or in part, by any gain on the underlying position.

Hedging Limitations. We may, but are not required to, employ various hedging techniques. The extent and effectiveness of such hedging strategies may vary substantially. Moreover, the Funds' portfolio is not required to be fully hedged. If employed, hedging techniques may be directed toward general market risks, default risks, recovery risks, correlation risks, volatility risks, interest rate risks, credit risks, collateral risks, spread risks, currency risks, liquidity risks or certain issuer risks. Typically, there are numerous investment risks which will not be hedged or necessarily capable of being hedged as a practical matter. To the extent unhedged, portfolio positions will, in general, be fully exposed to market and investment risks. Hedging techniques have a variety of limitations. Hedging against a decline in the value of a portfolio position by selling short, for example, does not eliminate fluctuations in the values of portfolio positions or prevent losses if the values of such positions decline, but establishes other positions designed to gain from those same developments, thus moderating the decline in the overall portfolio positions' value. Hedging through market index options may only protect against an overall market downturn, as compared with price declines in specific securities.

Hedge transactions generally also limit the opportunity for gain if the value of the portfolio position should increase, due to the hedging cost or price decline in the hedging position. For a variety of reasons, the firm, if it desires to utilize hedging techniques, may not seek or be able to establish a sufficiently accurate correlation between hedging instruments and the portfolio holdings being hedged. Such imperfect correlation may prevent the firm from achieving the intended hedge with respect to a portfolio position or may expose the Funds to risk of loss. Such losses can include losses on the hedged position, the attempted hedge position or both, and could be substantial. There can be no assurance or expectation, therefore, that any investment positions of the Funds will be hedged against investment risks or that such hedging strategies will in fact prove successful. Hedging may decrease the return on investment in the Funds.

Substantial Competition. Other investors with significant capital and positioning in the market will compete with the Funds for investment opportunities. These competitors may include investment banking firms, banks and other financial institutions, hedge funds, family offices, private institutional investment partnerships, individuals and others. These competitors may have greater resources than the Funds and may have different investment objectives than the Funds, enabling them to accept more risk or pay higher prices than we deem appropriate for the Funds. Due to substantial competition, the Funds may be unable to find attractive investments that offer suitable rates of return and there can be no assurance that the Funds will be able to fully invest its capital.

Conflicts of Interest

There are a number of actual or potential conflicts of interest between and among the firm, the Portfolio Managers, the Funds and the trustee of the Master Fund. Among those that should be considered by prospective investors are the following:

Possible Conflicts with Other Clients and Accounts of the Firm. As the individuals primarily responsible for the investment activities of the firm, the Portfolio Managers have investment responsibility for (i) the Funds and (ii) such other investment entities and managed accounts as may be established from time to time. The Portfolio Managers may have responsibilities for investment management of additional private investment funds, managed accounts, other clients and other entities, the investment strategies and techniques of which may be substantially similar to, or which may differ in any number of respects from, those of the Funds. The Portfolio Managers may further determine to enter into other businesses and ventures. The existence of any future investment funds, accounts, other clients, other businesses and/or ventures may create a number of conflicts of interest.

The firm may provide investment advisory services to additional managed accounts, investment vehicles or clients. The firm, the Portfolio Managers and their affiliates may also determine to engage in other businesses. The existence of such multiple investment vehicles, advisory accounts, clients or other businesses may create a number of conflicts of interest.

Possible Agreements with Certain Investors. The Funds and the firm may from time to time enter into agreements with one or more investors, including any of the Portfolio Managers, or any other principal or employee of the firm or any affiliates, whereby in consideration for agreeing to invest certain amounts in the Funds and other consideration deemed material by the firm, such investors may be granted favorable rights not afforded to other investors, generally. Such rights may include, but are not limited to, one or more of the following: special rights to make future investments in the Funds, other investment vehicles or managed accounts, as appropriate; special withdrawal rights, relating to frequency, notice and/or other terms; rights to receive reports from the Funds on a more frequent basis or that include information not provided to other investors (including, without limitation, more detailed information regarding positions); rights to receive reduced rates of the incentive fee and allocation and/or management fee; rights to receive a share of the incentive fee or allocation, management fee or other amounts earned by the firm or its affiliates; ownership in the firm or its affiliates; and such other rights as may be negotiated between the Funds and such investors. The Funds and the firm may enter into such agreements without the consent of or notice to the other investors.

In addition, the firm may from time to time enter into similar agreements with one or more managed account investors. It should be noted that managed account investors are typically provided with additional transparency with respect to the investment positions of their managed accounts and may be provided with investment discretion on a case-by-case basis, real-time, direct access to the managed accounts portfolio positions, on a negotiated, case-by-case basis.

Allocation Issues Generally. We allocate investment opportunities between the Funds and any other investment vehicles and managed accounts that are managed by the firm or its affiliates at any given time by applying such considerations as are deemed appropriate, including relative size of such vehicles and accounts, amount of available capital, size of existing positions in the same or similar securities, leverage, risk and return profile, risks to a particular investment or investments and other factors. Although such allocations might be *pro rata* as to the Funds and such other vehicles and accounts, they are not necessarily so. The Funds are not entitled to investment priority and may not necessarily participate in every investment opportunity. In cases where a limited amount of a security or other instrument is available for purchase, the allocation of such security or other instrument, as between the Funds and any such other vehicles and accounts, may necessarily reduce the amount thereof available for purchase by the Funds.

Time Commitments. The Portfolio Managers devote such time to the business of the Funds as they each deem necessary. However, the firm and the Portfolio Managers may have other ongoing investment and business responsibilities, including, but not necessarily limited to, the management of a number of other clients, investment vehicles and managed accounts and marketing and administrative responsibilities. In addition, the firm may establish additional investment vehicles and managed accounts. The existence of multiple clients, managed accounts and investment vehicles may create conflicts as to time and resource commitments on the part of the firm and the Portfolio Managers, which could have the effect of reducing the time they will devote to the investment activities of the Funds.

Valuation and Other Matters. The firm is responsible along with the Funds' administrator and in accordance with the firm's valuation policy for a variety of important matters affecting the Funds. Among other matters, they calculate the Funds' net asset value. Such valuation affects reported performance as well as the calculation of the incentive fees and allocations paid or allocable and the management fee payable to the firm. Although the Funds' operative documents prescribe the method of valuing different types of Fund investments, which generally involves using current market price information, there are investments as to which the firm has certain elements of discretion in determining valuation. The firm supplies some market data to the Funds' administrator, which the administrator uses to calculate position valuations. Furthermore, in the event the firm is provided with, or otherwise come into possession of, information which leads the firm to determine that one or more valuations of Fund assets for a prior period are inaccurate, the firm has the authority to adjust or amend such prior valuations as the firm deems appropriate, and to adjust or amend any reports or statements of the Funds (as applicable, and whether or not previously issued) with respect to such prior periods.

In general, the firm (or its affiliates and designees) has broad discretion as to the determination or resolution of a wide variety of matters, including economic and tax allocations, withdrawals or redemptions, distributions and other issues, any of which could significantly affect a particular investor or investors.

Allocation of Profits and Losses. In addition to sharing in net profits on the basis of its invested capital, the firm or its affiliate is entitled to receive a semi-annual incentive fee and/or allocation equal to 20% of the realized and unrealized net profits initially allocated to each investor, but is allocated net losses solely on the basis of its invested capital. Although a relative payment or allocation of profits and losses such as the incentive fee or allocation has largely become a customary standard for private investment funds, this type of relative payment or allocation of profits and losses can be characterized as creating an incentive for the firm to engage in speculative investment and thus a potential conflict with the interests of the investors. Since the allocation is based upon portfolio gains, both realized and unrealized (net of realized and unrealized losses), it is possible that the firm or its affiliate may receive an incentive fee or allocation based upon unrealized appreciation in particular positions that was not in fact achieved upon disposition of such positions.

The incentive fee and allocation is determined on a semi-annual basis, in contrast to an annual allocation (as is common in many other private investment funds). Although the incentive fee and allocation is subject to a customary “high-water mark” limitation, whereby prior losses of an investor must be effectively recovered before a subsequent incentive fee and allocation may be earned, as well as an adjustment at the end of the initial lock-up period with respect to each investment, there is no requirement that any losses in future semi-annual periods be recouped by offsetting against incentive fees or allocations in respect of prior period profits. Accordingly, it is possible that under a semi-annual allocation approach the firm or its affiliate may receive and retain incentive fees or allocations semi-annually, notwithstanding Fund losses in subsequent semi-annual periods which would otherwise reduce the allocation under an annualized method. Further, each investment by an investor is subject to a separate incentive fee or allocation calculation. As a result, an investor may be subject to an incentive fee or allocation in respect of one investment while the investor’s investment in a Fund, on the whole, experiences losses. The terms of the incentive fee and allocation have been determined unilaterally by the firm and do not reflect arms’ length negotiation. A description of the incentive fee and allocation, including the “clawback,” is set forth in Item 5 under the heading “*Fees and Compensation – Fees.*”

Possible Conflicts Regarding Brokerage Allocations. The firm may allocate brokerage on the basis of a broker’s agreement to pay all or part of certain research-related expenses of the Funds and the firm, provided such expenses qualify for a “safe harbor” provision in the federal securities laws. Accordingly, to the extent such allocations result in the payment by such brokers of expenses that would otherwise be borne by the firm, it will realize an economic benefit from such allocations and may be deemed to have a financial conflict of interest with the Funds. The firm will not endeavor to allocate, as between the Funds and any separate accounts, particular items of expenses paid relative to the vehicle or account generating the particular commission revenues utilized for payment, except in limited circumstances when deemed appropriate. Accordingly, brokerage allocations from the Funds may also have the effect of indirectly benefiting other entities and accounts managed by the firm or its affiliates.

Information Provided by the Firm. Factual information contained in this brochure, including without limitation, the investment strategy and policies, biographical and certain other information, has been furnished largely by the firm and its affiliates and in general has not been independently confirmed or verified. Therefore, investors should seek to confirm such information, seek additional information or conduct further investigation as they deem appropriate in connection with a decision to invest in the Funds or a separate account.

Item 9 – Disciplinary Information

Neither the firm nor any of its principals has ever been sanctioned or reprimanded by any regulator or self-regulatory organization, nor has any such person been sued (or, to our knowledge, threatened with litigation) by any client or by any local state or federal authority on behalf of a client.

Item 10 – Other Financial Industry Activities and Affiliations

Varden Pacific General Partner I LLC is a Delaware limited liability company and the general partner of the Onshore Fund.

Varden Pacific General Partner II LLC, a Delaware limited liability company, is the general partner of the firm and is owned by Dennis Lin, Brad Scelfo and Shawn Stoval.

A description of the relationship between the firm and the Funds is set forth in Item 4 under the heading “*Advisory Business – Structure, History and Ownership.*”

Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading

Code of Ethics

We have established a Code of Ethics pursuant to Rule 204A-1 under the Advisers Act as part of our overall compliance program. The Code of Ethics includes policies and procedures relating to personal securities trading by firm personnel and protection against the misuse of material nonpublic information. The Code of Ethics is designed to prevent, among other things, any improper conduct whenever any potential conflict of interest may exist with respect to any fund or investment portfolio. In addition, the Code of Ethics requires the firm and/or all supervised persons of the firm to safeguard and prevent dissemination of non-public information, to refrain from engaging in self-interested transactions and certain outside business activities without prior approval, to develop adequate internal accounting controls and maintain proper books and records, and to refrain from insider trading. The Code of Ethics also outlines the duties of care and loyalty that the firm and its supervised persons are required to follow with respect to clients, including our obligation to exercise a high degree of care, to seek best execution, to safeguard client assets, to act in the best interest of clients and to render impartial advice to clients. A copy of the Code of Ethics is available upon written request to Dennis Lin, Chief Compliance Officer, c/o Varden Pacific LP, 201 Mission Street, Suite 2230, San Francisco, California 94105.

Interested Transactions

The firm's Code of Ethics requires employees to pursue the best interests of the firm and its clients and not to put their own personal trading interests ahead of such interests. Governing principles include but are not limited to:

- employee transactions involving a conflict of interest between an employee and the firm, its Funds or investors are prohibited;
- employees are prohibited from using access to the firm's proprietary, Fund or investor information in any way to advantage their own personal investing;
- employee transactions that present potentially material reputational or regulatory risk to the firm are prohibited;
- employees may not trade, or recommend that others trade, in a security or related derivative while in possession of material, non-public price sensitive information about the security or an issuer of a security;
- employees may not trade, or recommend that others trade, in a security or related derivative if they are aware that the firm is effecting or proposing to effect a transaction for its own account, a Fund or a client in a security or related derivative of the same issuer; and
- employees may not trade, or recommend that others trade, in a security or related derivative if they are aware of a research report or other communication which has not yet been publicly disseminated.

Firm employees may not engage in transactions prohibited by the Restricted List which is managed and updated by the Firm's CCO. A complete detail of policies and procedures relating to employee account trading can be found in the firm's Employee Personal Account Trading Policy, which is available upon request.

Item 12 – Brokerage Practices

Selection of Brokers; Directed Brokerage

We have investment discretion with respect to the initiation of portfolio securities transactions for the Funds. We have the authority to select broker-dealers to execute such transactions and may utilize a number of broker-dealers to effect transactions for the Funds. Broker-dealers will be selected by based upon a variety of factors, subject at all times to principles of best execution, including:

- the amount of commission (or bid/offer spread);
- quality of execution;
- expertise in particular markets;
- reputation;
- experience and financial stability of the broker-dealer;
- quality of service;
- familiarity both with investment practices generally and the techniques employed by the Fund; and/or
- research and analytic services and clearing and settlement capabilities.

We may in our discretion select, and change, brokers for the Funds.

Soft Dollars

We do not make use of soft dollars. If we do determine to make use of soft dollars in the future, we will do so in compliance with the safe harbor provided by Section 28(e) of the Securities Exchange Act of 1934.

Aggregation of Orders

When we deem the purchase and sale of securities to be in the best interest of the Funds or a separate account, we may aggregate the securities to be purchased or sold in order to obtain superior execution and/or lower brokerage expenses. In particular, execution prices for identical securities purchased or sold on behalf of multiple investment vehicles or separate accounts in any one business day may be averaged. In such event, we will allocate the securities purchased or sold, as well as expenses incurred in the transaction, among the Funds and any participating separate accounts by applying such considerations as we deem appropriate, including:

- relative account size of such investment vehicles and accounts;
- amount of available capital;
- size of existing positions in the same or similar securities;
- impact of leverage; and/or
- tax considerations and other factors.

Although such allocations may be *pro rata* as to the Funds and any separate account, they will not necessarily be so where allocation considerations, such as availability of capital, positions in similar securities or differing objectives dictate a different result. The Funds will not be entitled to investment priority over other managed investment vehicles or separate accounts and may not necessarily participate

in every investment opportunity. We will endeavor to make all investment allocations in a manner that we consider to be the most equitable to all Funds and separate accounts.

Trade Errors

We have adopted a policy for the purpose of addressing trade errors that may arise, from time to time, with respect to the securities transactions of the Funds and separate accounts. An example of a trade error is the sale of a security when it should have been purchased. Pursuant to the policy, we will seek to identify and correct any trade errors in an expeditious manner. If a trade error caused by the Firm results in a loss for a Fund or a separate account, the Firm will reimburse such Fund or separate account. Gains from trade errors may not be used to offset losses from trade errors. “Soft dollars” or “client commissions” will not be used, either directly or indirectly, to correct trade errors. The determination of whether or not a trade error has occurred will be in our sole discretion.

Item 13 – Review of Accounts

Reviews

We review the holdings of the Funds and any separate accounts on an ongoing basis. Individual investments are evaluated with respect to their individual merit and whether they are additive or subtractive to the overall riskiness of the Funds’ and any separate account’s portfolios. Such review is performed by Dennis Lin, Shawn Stoval and Brad Scelfo.

Reports

Funds. In general, after the end of each fiscal month, each investor is provided with an unaudited account statement regarding the applicable Fund’s operations and performance for the period covered. The books and records of the Funds are audited at the end of each fiscal year by a firm of certified public accountants, and investors will be furnished with audited year-end financial statements, including a statement of operations for such fiscal year, and certain tax reporting information if applicable. In general, the Funds’ financial statements are prepared in accordance with U.S. generally accepted accounting principles. In such instances, we may make modifications to our accounting practices in order to eliminate such qualifications.

Separate Account. Clients with a separate account directly own the assets in the separate account and have the primary relationship with the custodian holding their assets. These custodians send such clients brokerage statements regarding the assets in their accounts. These reports list the account positions, activity in the account over the covered period, and other related information. These clients are also sent confirmations following each brokerage account transaction unless receipts of confirmations has been waived by the client. We also send unaudited monthly reports to separate account clients.

Item 14 – Client Referrals and Other Compensation

We have retained Spearhead Capital LLC as a third-party marketer to solicit potential investors in the Funds and separate account clients. Third-party marketers will generally receive 20% of the management fees and performance-based compensation we receive in respect of investors in the Funds and separate account clients solicited by the respective marketers. Third-party marketers that we have terminated our engagements with may, in some cases, continue to receive some or all of their previously agreed upon compensation for a certain period of time after the termination of their respective marketing agreement. We may in the future enter into additional compensation arrangements with solicitors for new investors. To the extent applicable, solicitations of prospective investors and clients are made in accordance with SEC

Rule 206(4)-3 adopted under the Advisers Act. We do not receive any economic benefit from any person that is not a client for providing investment advice or other services to our clients.

Item 15 – Custody

We currently entrust the custody of the Funds' assets to US Bank National Association, Cayman Branch. We may change custodians, and/or retain one or more additional custodians, in our discretion.

With respect to separate accounts, brokerage statements are generated not less than quarterly. These statements are sent directly to the client by the account custodian. These reports list the account positions, activity in the account over the covered period, and other related information. Separate account clients are also sent confirmations following each brokerage account transaction unless receipt of confirmations has been waived by the client. Clients should carefully review statements they receive from their custodians.

Item 16 – Investment Discretion

A description of the investment discretion that we exercise with respect to the Funds and any separate account is included in “*Advisory Business – Types of Advisory Services*,” above. We generally exercise investment discretion pursuant to power of attorney that is granted by the Funds and any separate account clients as part of the investment advisory agreement relating to each such client. Separate account clients may be allowed to consider and approve each investment before investing; for such accounts, we do not have full investment discretion.

Item 17 – Voting Client Securities

We have established a set of “Proxy Voting Policies and Procedures” that are designed to ensure that the firm complies with the Advisers Act and Rule 206(4)-6 thereunder. Under the Advisers Act, an adviser owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting. To satisfy its duty of care, an adviser with proxy voting authority must monitor corporate events and must, except in unusual circumstances, vote proxies. To satisfy its duty of loyalty, an adviser must ensure that no conflict of interest interferes with the adviser's ability to vote proxies in a client's best interests. Rule 206(4)-6 under the Advisers Act requires all federally registered investment advisers that exercise voting authority over client proxies to adopt policies and procedures reasonably designed to ensure that the adviser votes proxies in the best interests of its clients.

These Proxy Voting Policies and Procedures apply whenever a Fund or investor has, whether implicitly or expressly, granted us the authority to vote proxies on its behalf. In some cases, the Fund or investor's agreement with us expressly provides that we shall have the power to vote proxies. Where the Fund or investor has entrusted us with full discretionary authority over its account, the grant of discretionary authority implicitly includes the authority to vote proxies. Separate account clients may have the option of receiving proxy voting information directly, in which case we will not vote proxies in respect of securities held in their accounts.

We vote proxies with respect to securities held in a Fund or a separate account in the manner that we believe is in such parties' best interests. Unless otherwise instructed by a Fund or a separate account client, we believe that the maximization of the value of a client's investments constitutes the client's best interests. Our specific policies with respect to certain specific types of voting decisions are set forth in the Proxy Voting Policies and Procedures, a copy of which will be provided upon request. Where we believe that it

is in a Fund or client's best interests, we will deviate from the general approaches summarized in the Proxy Voting Policies and Procedures.

Upon request by a client, we will provide the client with information regarding how we voted with respect to securities held in the client's account and a copy of these Proxy Voting Policies and Procedures.

Item 18 – Financial Information

We do not require or solicit prepayment of more than \$1,200 in fees six months or more in advance. Therefore, we are not required to include a balance sheet for our most recent fiscal year.