

Forecast Contract Risk Disclosure

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1. Description of Forecast Contracts

Contracts listed on the ForecastEx Exchange are forecast contracts and classified by the CFTC as Swaps.¹ A forecast contract is a contract whose value is based on whether a specific event will occur at or before a specific time. The Contracts are described by a “Yes” or “No” proposition, known as the Event Question.² The “Yes” contract and “No” contract are two separate forecast contracts each with a unique contract ID. Market Participants place Bids on either the “Yes” or “No” forecast contract at prices between \$0.02 and \$0.99. When the combined value of the best Bids for the “Yes” Position and “No” Position equal \$1.01, the Exchange executes the Event Positions by pairing the Bids and then reports the Event Positions to the Clearinghouse.

Once the pairing has been reported to the Clearinghouse, each Market Participant will have entered into a Contract with ForecastEx, and the Clearinghouse has the obligation to pay any

¹ Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed.Reg. 48208 (August 13, 2012)

² Capitalized terms have the same meaning assigned to them in the ForecastEx Rulebook.

monies required at such time as the Event Position settles. Event Positions are not novated because the Clearinghouse is the original contractual counterparty to each pairing.

All ForecastEx contracts must be fully collateralized, meaning a Futures Clearing Merchant (“FCM”) who is a member of the Exchange will reject any Bid placed by a customer unless funds sufficient to fully collateralize the Bid are deposited in an account with the FCM prior to the customer placing the Bid.

Once an forecast contract expires, it will no longer be available for pairing. Subsequently, the Outcome of the Contract will be determined and the Contract will go through Settlement. Depending on the outcome of the Event Question, the holder of either the “Yes” or “No” Contract will be entitled to receive the Settlement Value of \$1.00, while the opposing “Yes” or “No” Contract will expire with no value.

Forecast contracts executed at ForecastEx cannot be sold or transferred to another Exchange. Contracts can only be exited before Resolution by acquiring an offsetting position, achieved by holding both a “Yes” and a “No” Position with the same Event question. Once a position has been offset, it will be settled the following Banking Business day by ForecastEx crediting the account \$1.00 for each “Yes”/”No” pair.

Forecast contracts are a type of derivative, in that they derive their value from an underlying asset. However, forecast contracts have a number of important distinctions from other derivative products. Unlike futures and options, Event Positions are fully-collateralized and cannot be purchased on margin. Additionally, forecast contracts are not marked-to-market. As a result, Event Positions will never require the deposit of additional funds to maintain an existing position. Forecast contracts are further differentiated from other derivatives in that they are not restricted to using a tradeable financial instrument as their underlying asset, and are always settled by cash settlement. Finally, the value of a futures or in-the-money options contract at expiration will vary depending on the price of the underlying asset, whereas Event Positions will either have a Settlement value of \$1.00 or \$0.

2. Uses of Forecast Contracts

1. Risk Management

Risk managers seek to manage portfolio risk without necessarily seeking to change the makeup of the portfolio. While there are many established strategies and products for managing portfolio specific or microeconomic risks, there are few existing options for managing macroeconomic and climate risks. Many ForecastEx Contracts are based on Event Questions that are macroeconomic in nature. In this way, a risk manager can potentially manage the portfolio’s risk by taking a “Yes” or “No” position that corresponds to the outcome of the macroeconomic or climate event which would have a negative effect on the portfolio, seeking to secure a benefit to counter the potential economic loss. This strategy may not be appropriate for all portfolios and may involve more risk than a traditional hedge as it is not meant to be a substitute for an anticipated purchase or sale.

II. Planning

The prices of Forecast contracts represent market forecasts of the probability of future events. For example, a “Yes” contract with a price of \$0.50 means that the market is forecasting a 50% probability that the Event Question resolves to “Yes”. Given the wide range of economic and climate events that ForecastEx lists contracts on, Market Participants can use the pricing information gleaned from participating in ForecastEx’s markets to inform their expectations about the likelihood of future events and plan accordingly.

III. Arbitrage

Arbitragers seek to profit by simultaneous buying and selling derivatives products in different markets in order to take advantage of perceived mispricing in the products. The macroeconomic events from which Events Contracts are derived from have effects on a wide array of financial products. There are a number of potentially profitable strategies where an arbitrager could buy or sell a financial product, while simultaneously buying a forecast contract whose underlying has a significant impact on the financial product. ForecastEx makes no claims about the effect an Event Question will have on any other financial product, or any perceived relationship between pricing of an Events Contract and any other financial product.

IV. Speculation

Speculators seek to profit by exiting a Forecast contract, at offset or Resolution, for a greater value than it was purchased for. Speculation involves substantial risk and can lead to large losses as well as profits. Before engaging in speculation, a Market Participant should ensure that they are able to withstand any losses that might result from such a strategy.

3. Forecast Contract Risks

I. Market Risk

The outcome of an forecast contract cannot be known in advance. A Market Participant’s expectations may not match the outcome of the Event, which can lead to unexpected losses. Market Participants should be prepared for the possibility of losing their entire investment. Changes in the likelihood of an underlying event may not necessarily result in a change in the price of the Event Market, which could prevent a customer from offsetting an existing position at a profit.

II. Pricing Risk

The prices of forecast contracts are dependent on the market’s expected probability of events occurring, which makes traditional derivative pricing models inapplicable for forecast contracts.

Forecast contract prices may not always be reflective of the actual probabilities of the Events occurring, which can lead to unexpected losses for Market Participants.

III. Source Agency risk

The value of an forecast contract is dependent upon the outcome of events which are reported by third party Source Agencies. Market Participants may be exposed to risk if these Source Agencies' data security is compromised, if the reported data is not accurate, or if the data is not reported at the expected date or time. Market Participants should familiarize themselves with ForecastEx's procedures for minimizing and handling Source Agency risk should it arise (Rule 415 in the Rulebook). These procedures may delay Settlement for customers, or disrupt the market, leading to potential losses for Market Participants.

IV. Liquidation risk

Market Participants may not be able to offset their positions if there is insufficient volume in the opposing forecast contract. Market Participants may also struggle to offset their positions if the opposing forecast contract has insufficient Bid depth. These could cause the pricing of contracts to not accurately correspond to the market's prediction of the underlying Event, and Market Participants would be forced to pay higher prices to offset their positions.

V. Trading Halt Risk

Exchanges have the authority to initiate trading halts if they deem it in the interest of Market Participants, which would prevent Market Participants from exiting their positions, and could affect their portfolios and strategies. The CFTC can also direct the Exchange to initiate a trading halt. Market participants should know and understand the emergency procedures that the Exchange has in place (Rule 409) that may lead to trading halts.

VI. FCM Risk

Market Participants will be exposed to risks associated with the FCM including the failure of the FCM's hardware and software, bankruptcy of the FCM, and the FCM failing to provide to ForecastEx adequate funds to guarantee their customer's Bids. These risks may result in Bids (including offsetting Bids) not being executed according to the Market Participants instructions or not being accepted. Market Participants should consult their FCM concerning the nature of the protections in place to minimize these risks.

VII. Affiliate Risk

Affiliates of ForecastEx may participate on the ForecastEx exchange subject to the requirements in Rule 208. Rule 208 requires that ForecastEx must publish on its website a description of the Affiliates participating at ForecastEx, a description of the affiliate's purpose in participating, and a summary of the conflict of interest policies that ForecastEx employs to prevent and mitigate any potential conflicts of interest.

The link below shows the page on ForecastEx's website which contains information about Affiliate activity at ForecastEx: forecastex.com/affiliation/

Customers of ForecastEx may access ForecastEx through any Member with which they have an account. The below link contains information as to which entities are ForecastEx Members: forecastex.com/membership/#members

VIII. Other risks

There are unforeseen operational risks associated with human error, systems failures, cyber-attack, or inadequate procedures and controls that may pose a risk to the success of Market Participants' bids. Since ForecastEx is a fully electronic exchange and clearinghouse, the software system could be subjected to temporary interruptions or failure. If any of the Events listed above occurred, it could lead to potential losses for the customer.