

CLIFFWATER^{L.L.C.}

INVESTMENT ADVISORY SERVICES

Los Angeles • New York

**Hedge Fund Operations Due Diligence Report
D.E. Shaw Composite Fund
D.E. Shaw Multi-Asset Fund**

May 2011

Investment Due Diligence Report provided under separate cover.

Hedge Fund Operations Due Diligence Report

| | | | |
|---------------------|--|------------------|--------------|
| Firm Name: | D.E. Shaw & Co., Inc. | | |
| Fund Name: | D.E. Shaw Composite Fund D.E. Shaw Multi-Asset Fund | | |
| Style: | Multi-Strategy | Location: | New York, NY |
| Review Date: | May 17, 2011 | Reviewer: | [REDACTED] |

| Operations Score: [REDACTED] | | | |
|--------------------------------------|------------|-------------------------------|------------|
| 1. Business Management | [REDACTED] | 4. Valuation | [REDACTED] |
| 2. Trading and Investment Operations | [REDACTED] | 5. Risk Management | [REDACTED] |
| 3. Financing and Counterparty Risk | [REDACTED] | 6. Investor Related Practices | [REDACTED] |

Summary

Since Cliffwater's last operational review in April 2010, D.E. Shaw's middle and back office processes have remained stable, although the manager has implemented several operational and organizational improvements.

- At the end of 2010, Edward Fishman was appointed to the newly created role of COO. Fishman's role will focus on managing and improving the daily operations of the firm.
- Employees can now log on remotely to all firm applications and files from their personal computers. In a disaster recovery scenario, employees will be able to work from alternate locations without the need of company issued laptops.
- D. E. Shaw renegotiated their margin lockup terms [REDACTED]. This will enhance the overall cash management and financing activities of the firm.
- [REDACTED] Trade Manager, an electronic derivative trade confirmation platform, was implemented into the trade operations process. The platform will enhance controls and efficiency related to trade confirmations.

D.E. Shaw's team is approximately 1,300 employees, down from 1,600 in 2010. A portion of the headcount decrease is attributed to a reduction of employees focused on private equity investments. Employees are based in the New York headquarters, Washington DC, Bermuda, Kansas City, Houston, Silicon Valley, Los Angeles, London, Mumbai, Gurgaon, Hyderabad, Dubai, Tokyo, Boston, Shanghai and Hong Kong. The fund effectively meets most all industry operational best practices except for not disclosing its valuation policy to investors in writing. The manager does disclose FAS 157 levels to all investors on a quarterly basis, however.

Section 1: Business Management

Score: [REDACTED]

D.E. Shaw meets all business management best practices which assess firm organization, compliance, investor protections and disaster recovery.

D.E. Shaw has a compliance team of 15 professionals and a legal team of approximately 20-25 professionals. The compliance manual and code of ethics are comprehensive and require annual certification by all employees. The fund is registered with the SEC and, thus, has document retention policies and anti-money laundering screenings as required. The manager does not utilize soft dollars. With some limited exceptions for indexes and other broad-based market instruments, all employee

This report reflects information only through the date hereof. Our reporting relies upon the accuracy and completeness of financial and other information publicly available or provided to us by the fund manager, its professional staff, and through other references we have contacted. We have not conducted an independent verification of the information provided other than as described in this report. Our conclusions do not reflect an audit of the investment nor should they be construed as providing legal advice. Past performance does not guarantee future performance. The information contained herein is confidential commercial or financial information, the disclosure of which would cause substantial competitive harm to you, Cliffwater LLC, or the person or entity from whom the information was obtained, and may be protected from disclosure by applicable law.

personal trading requires pre-approval. All employees must send personal trade confirmations to the compliance team and there is a minimum required holding period of 30 days for all securities.

[REDACTED] D.E. Shaw has always had strong compliance policies and procedures in place to mitigate risk and ensure adherence to its insider trading policies. All employees are required to attend annual compliance training seminars and the compliance team monitors personal trading against a restricted trading list.

The firm has a comprehensive and detailed disaster recovery plan which includes a fully operational data center facility in [REDACTED]. This facility provides for the replication of critical files and connectivity to the firm's servers. In addition, there is a battery back-up in the building. All electronic books and records are backed up to the disaster recovery site on a near real time basis. Starting in 2011, D.E. Shaw's employees can log on remotely to access all files and systems from their personal computers, in addition to any firm provided computers.

The firm carries professional liability coverage including errors and omissions and directors and officers insurance. [REDACTED]

Best Practices Comparison

| Organization and Governance | | Yes | No |
|-----------------------------|------------|-----|----|
| 1 | [REDACTED] | | |
| 2 | [REDACTED] | | |
| 3 | [REDACTED] | | |
| 4 | [REDACTED] | | |
| Compliance | | | |
| 5 | [REDACTED] | | |
| 6 | [REDACTED] | | |
| 7 | [REDACTED] | | |
| 8 | [REDACTED] | | |
| 9 | [REDACTED] | | |
| 10 | [REDACTED] | | |
| 11 | [REDACTED] | | |
| 12 | [REDACTED] | | |
| 13 | [REDACTED] | | |
| 14 | [REDACTED] | | |
| Investor Protections | | | |
| 15 | [REDACTED] | | |
| 16 | [REDACTED] | | |
| 17 | [REDACTED] | | |
| 18 | [REDACTED] | | |
| 19 | [REDACTED] | | |
| 20 | [REDACTED] | | |
| 21 | [REDACTED] | | |
| 22 | [REDACTED] | | |
| 23 | [REDACTED] | | |

| | |
|-------------------|------------|
| 24 | [REDACTED] |
| Disaster Recovery | |
| 25 | [REDACTED] |
| 26 | [REDACTED] |
| 27 | [REDACTED] |

Background

| Criteria | Cliffwater Comments |
|---|---------------------|
| Firm structure: [REDACTED] | [REDACTED] |
| Fund structure and domicile [REDACTED] | |
| Compliance policies: [REDACTED] | |
| Specific policies: [REDACTED] | |
| Legal proceedings [REDACTED] | |
| Regulatory authorities: [REDACTED] | |

| | |
|---|------------|
| [REDACTED] | [REDACTED] |
| [REDACTED] | [REDACTED] |
| IT staff size and turnover: | [REDACTED] |
| Backup procedures: | [REDACTED] |
| Business continuity and disaster recovery plan: | [REDACTED] |
| Insurance coverage: | [REDACTED] |

Section 2: Trading and Investment Operations

Score: [REDACTED]

D.E. Shaw meets all trading and investment operations best practices which assess outside service providers, infrastructure, trading and accounting processes, counterparty monitoring, and cash management.

[REDACTED] administers the funds and [REDACTED] provides administration services for insurance and insurance-related positions. Prime brokers include [REDACTED]. The US counsel, [REDACTED] and Cayman Islands counsel, [REDACTED] are retained to advise the manager as needed.

D.E. Shaw has developed a sophisticated proprietary order management and execution system to handle the thousands of trades it executes each day in a wide range of products. Trades are executed primarily from New York, London, and Hong Kong offices, with some limited energy-related trading in Kansas City and direct lending in Houston. The trade flow process differs by desk but, generally, the firm uses electronic execution systems such as [REDACTED] or the [REDACTED] to execute trades.

Shaw reconciles positions a daily basis except for certain insurance and insurance-related activities, which are reconciled by [REDACTED]. All reconciliations are generated at every month end to support all month end valuations. The reconciliations are reviewed and stored electronically on the firm's server.

As part of the segregation of duties principle for D.E Shaw’s control process, all wires to third parties require the approval of two authorized signatories.

Best Practices Comparison

| Outside Service Providers | | Yes | No |
|---|--|-----|----|
| 28 | | | |
| 29 | | | |
| 30 | | | |
| Infrastructure | | | |
| 31 | | | |
| 32 | | | |
| 33 | | | |
| 34 | | | |
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| Trading Practices | | | |
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| Core Accounting Processes | | | |
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| 51 | | | |
| Cash, Margin, and Collateral Management | | | |
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| 53 | | | |
| 54 | | | |
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| 56 | | | |

| | | |
|--------------------|---------|----------|
| | Onshore | Offshore |
| Entity and Contact | | |

| Entity and Contact | Onshore | Offshore |
|--|---------|----------|
| Prime Broker | | |
| Administrator | | |
| Audit | | |
| Legal | | |
| Tax | | |
| Other (including custodian if not PB) | | |
| Changes in providers (3 yrs) | | |
| Any issues encountered in audit of firm or its products? | | |

| Criteria | Cliffwater Comments |
|--|---------------------|
| Organizational Structure: <div style="background-color: black; width: 200px; height: 40px; margin-top: 5px;"></div> | |
| Control structure and oversight <div style="background-color: black; width: 200px; height: 30px; margin-top: 5px;"></div> | |
| Trading team: <div style="background-color: black; width: 200px; height: 50px; margin-top: 5px;"></div> | |

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|--|--|
| | |
| Types of securities traded [REDACTED] | |
| Trading practices: [REDACTED] | |
| Trade flow process: [REDACTED] | |
| Trade confirmation and reconciliation: [REDACTED] | |
| Specialized groups [REDACTED] | |
| Reconciliation process with administrator: [REDACTED] | |
| Cash movements: [REDACTED] | |

Section 3: Financing and Counterparty Risk

Score: [REDACTED]

D.E. Shaw meets all financing and counterparty monitoring best practices which assess how the manager finances its portfolio and manages its cash.

The Treasurer oversees the firm’s financing of its portfolios, management of cash and liquidity, and banking and brokerage relationships, including the coordination of the firm’s activities with financing and trade counterparties. In 2010, D.E. Shaw was able to renegotiate their margin lockup term from [REDACTED]

The manager has made a substantial investment in its financing function to control and minimize its counterparty and liquidity risk. D.E. Shaw has negotiated ISDA master agreements with over 20 counterparties and repurchase agreements with several of the largest participants in the overnight repurchase market. In addition, it has some specific financing agreements in place for private placements and other illiquid investments to ensure it maintains a sufficiently liquid portfolio.

Best Practices Comparison

| Financing and Counterparty Risk | | Yes | No |
|---------------------------------|--|-----|----|
| 57 | | | |
| 58 | | | |
| 59 | | | |
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| 61 | | | |
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| 64 | | | |
| 65 | | | |

Background

| Criteria | Cliffwater Comments |
|---|---------------------|
| Sources of financing: [Redacted] | |
| Counterparties and terms of arrangements: [Redacted] | |
| Prime broker financing: [Redacted] | |
| Repo agreements [Redacted] | |
| ISDAs [Redacted] | |

| | |
|---|--|
| Frequency of settlement | |
| Other (i.e. CDOs, debt offerings, etc.) | |

Section 4: Valuation

Score:

D.E. Shaw meets all valuation best practices. The manager has always had an independent pricing team to verify all valuations at every month end. Mark Harvey, an internal hire, is now in charge of the pricing team.

are the official valuation agent and are able to price approximately 99% of the assets independent of the fund. At every month end, to verify the prices are accurate, the accounting group will independently value the portfolios and compare these prices to . The fund has established a Valuation Working Group to oversee the firm's valuation policy. The group includes the General Counsel, Chief Compliance Officer, Treasurer, CFO, the Head of Pricing and the Chief Risk Officer.


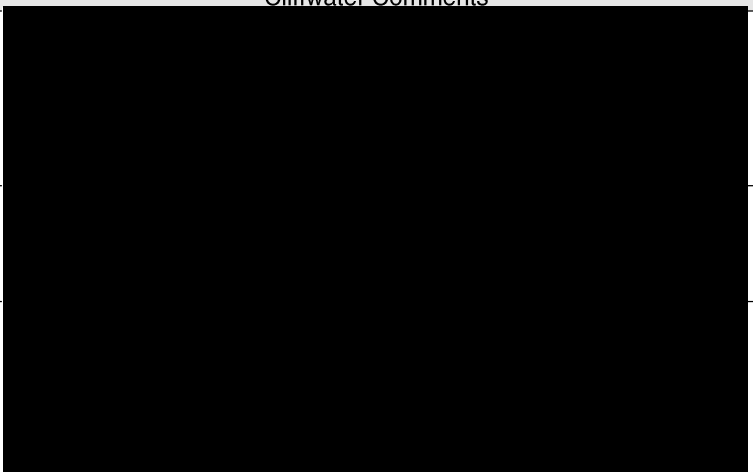

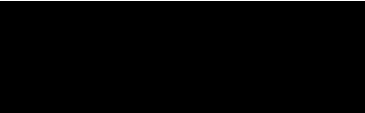
is retained to review certain illiquid or difficult- to- value investments in order to assist D.E. Shaw's valuation team. values 85% of the private positions. For investment positions for which third-party pricing sources are not available, utilizes widely accepted financial models to verify prices.

Best Practices Comparison


| Valuation Personnel | | Yes | No |
|---------------------------------------|--|-----|----|
| 66 | | | |
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| Valuation Policy | | | |
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Background

| Criteria | Cliffwater Comments |
|---|--|
| Month end closing process  |  |
| Valuation of exchange traded (level 1) assets:  | |
| Valuation of OTC / illiquid instruments / private placement (level 2 and 3) assets  | |

Section 5: Risk Management

Score: 

D.E. Shaw meets all risk management best practices. Firm-wide risk is overseen by the Risk Committee, which includes four of the six individuals on the Executive Committee. The committee meets approximately once a week and every two weeks there is a more formal review of overall risk on a firm-wide basis.

The Risk Committee oversees the risk management and capital allocation across the firm. The Committee is led by Mr. Peter Bernard, the former President of RiskMetrics. He leads a team of four professionals in New York, NY and five in Hyderabad, India.

One key risk management tool used is its capital-at-risk allocation to each strategy. However, the firm also utilizes position and issuer level limits. The risk committee has also established long term volatility targets and scenario limits. Liquidity risk is also monitored as part of the overall risk management process. D.E. Shaw keeps unencumbered cash at several custodial accounts to meet margin calls and cash redemptions.

Best Practices Comparison

| Structure | | Yes | No |
|-----------------------------|--|-----|----|
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Background

| Criteria | Cliffwater Comments |
|--|---------------------|
| Structure of risk management group: <div style="background-color: black; width: 200px; height: 40px; margin-top: 5px;"></div> | |
| Liquidity risk and funding: <div style="background-color: black; width: 200px; height: 40px; margin-top: 5px;"></div> | |

Section 6: Investor Related Practices

Score:

D.E. Shaw meets all disclosure and investor terms best practices except that it does not make its written valuation policy available to investors. Although it will not disclose the policy in writing, the investor relations team is willing to discuss its valuation procedures upon request.

Investors receive weekly and monthly performance estimates. On a monthly basis, they also receive a report showing finalized returns and a breakdown of certain portfolio characteristics and exposures. The manager also sends a quarterly investor report outlining recent developments related to the portfolio or the manager.

Quarterly operational reports are also provided to investors. These reports include information related to the fund's FAS 157 Level breakdowns, capital, and largest counterparties. The quarterly report gives investors greater transparency into the funds operations.

D.E. Shaw's financial statements are audited by Ernst & Young LLP and audited financial statements are sent to investors within 120 calendar days of year end, which is in line with the industry standard. All tax preparation is performed by D.E. Shaw's tax department.



Best Practices Comparison

| Initial Disclosures | | Yes | No |
|---------------------|--|-----|----|
| 137 | | | |
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| 141 | | | |

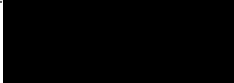
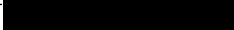
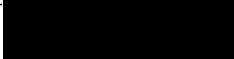

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| Fees and Expenses | |
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| Investor Terms | |
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Background

| Criteria | Cliffwater Comments |
|--|---------------------|
| Quality and frequency of reporting Side letters | |

| Criteria | Cliffwater Comments |
|---|---|
| | |
| Fund financial and tax statements:  |  |

Meeting History

| Date | Location | Cliffwater Attendees | Manager Attendees |
|-------------------|-----------------|---|--|
| February 20, 2009 | New York, NY |  | Trey Beck (IR), Eugenie Kim (IR), Erik Simpson (IR), Peter Bernard (Director of Risk Management) |
| November 4, 2009 | Conference Call |  | Eugenie Kim (IR), Erik Simpson (IR) |
| April 28, 2010 | New York, NY |  | Nancy Dornbush (Senior Vice President), Eugenie Kim (IR), Erik Simpson (IR) |
| May17, 2011 | New York, NY |  | Nancy Dornbush (Senior Vice President), Eugenie Kim (IR), Erik Simpson (IR) |

Appendix: Glossary

| | |
|-----------------------|--|
| Administrator | A service provider such as Citco or International Fund Services that handles administrative responsibilities such as calculating the fund's NAV on a monthly basis, sending the investors performance reports, and maintaining the official books and records of the fund. |
| Fair Value (FAS 157) | FASB Statement No. 157, Fair Value Measurements ("FAS 157"), defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." Cliffwater reviews valuations according to the Fair Value hierarchy established by FAS 157, the three levels of which are described below. |
| Level 1 assets | Liquid assets with readily observable prices, and therefore a reliable market value. Level 1 assets typically include stocks, bonds, mutual funds, and any other assets that have a regular "mark to market" pricing mechanism. |
| Level 2 assets | Assets with a value based on market inputs that are not directly observable on a central exchange. These assets are often priced via quotations from dealers. An example of a level 2 asset is a credit default swap which is typically priced via indicative quotations from broker dealers. |
| Level 3 assets | Illiquid assets with a value that cannot be determined by observable measures. The fair value of a level 3 asset can only be estimated by using significant assumptions as inputs to the valuation model. Mortgage-backed securities are an example of this type of asset. |
| Leverage | <p>The use of explicit debt (i.e. borrowing) or implicit debt (i.e. derivatives) to achieve investment positions that exceed invested capital (NAV), thereby amplifying return but also increasing risk. A common leverage calculation is the ratio of gross notional exposure to invested capital. For example, a \$100 investment in BP stock coupled with a \$100 short sale of Exxon stock yields gross notional exposure of \$200. Leverage in this example can be described in at least two ways:</p> <ol style="list-style-type: none"> The portfolio has 200% gross exposure (equal to \$200 gross notional exposure divided by \$100 NAV) The portfolio is one time (1x) levered (equal to \$100 in debt divided by \$100 NAV) <p>As illustrated in the example, the \$200 gross notional exposure equals the absolute value total of both \$100 long ("gross long") and \$100 short ("gross short") asset exposures. The measurement of gross notional exposure varies by asset class:</p> <p><i>Equities</i> – the market value of long and short positions <i>Corporate Debt and Municipal Bonds</i> – the market value of long and short positions <i>US Treasuries (and other highly rated government debt)</i> – the market value of long and short positions, adjusted to a 10 year bond equivalent maturity (approximate 9 year duration), so that a \$100 exposure to a 2 year duration bond is recognized as a lower risk compared to a \$100 20 year duration bond. The \$100 3 year duration bond is said to have a \$33 10 year bond equivalent exposure (\$100 times 3, divided by 9) while the \$100 20 year duration bond is said to have a \$222 10 year bond equivalent exposure (\$100 times 20, divided by 9) <i>Options</i> – the delta adjusted exposure rather than the total notional value of the underlying reference asset. Delta adjusted exposure represents the implied shares/holdings necessary to hedge the options position <i>Credit Default Swaps</i> – total notional exposure of the underlying reference credit <i>Interest Rate Swaps</i> – total notional exposure (expressed as 10-year bond equivalent, per the duration adjustment process described above) to reference security or index <i>Futures/Forwards</i> – total notional exposure to reference security or index</p> |
| Net Asset Value (NAV) | A fund's total assets less total liabilities. |
| Notional Exposure | The total dollar exposure represented by a position. Due to leverage, this amount may be greater than the equity in the position. For example, a CDS contract offering \$1 million of protection has a notional value of \$1 million even though the cost of the contract itself is likely to be a small fraction of that amount. |
| Gross Long | The total notional exposure of all long positions in a portfolio. Long positions benefit from increases in securities prices. |
| Gross Short | The total notional exposure of all short positions in a portfolio. Short positions benefit from decreases in securities prices. |
| Net | The difference between a portfolio's gross long and gross short exposures. A net long |

| | |
|-------------------|---|
| | position indicates a higher portion of long positions in the portfolio, and that the portfolio should generally benefit from an increase in asset prices. A net short position indicates the opposite. |
| Total Gross | The sum of a portfolio's gross long and gross short exposures. |
| Operations Score | A measure of how well the firm meets best practice standards on a scale of A (meets all best practice standards) to F (does not meet several best practice standards). A rating of "C" or lower indicates Cliffwater believes the firm's departure from best practices could hurt returns or lead to the misappropriation of firm assets. |
| Prime Broker | A prime broker custodies assets, provides settlement services, facilitates the borrowing of securities for short positions, and may provide performance reporting for hedge funds. JPMorgan, Goldman Sachs, Morgan Stanley and UBS are large prime brokers. |
| Side Pocket | A segregated portion of a portfolio that may be used to hold illiquid, less frequently priced securities. Once a holding is placed in a side pocket, only current investors participate in its performance. Subsequent investors do not share in the gains/losses associated with assets previously placed in side pockets. Performance fees are paid when side pocket investments are realized. Assets placed into side pockets are not available for withdrawal until the investments are realized. |
| Soft Dollars | Commission credits from trading securities that can be used to pay for research or other services that brokers provide to hedge funds and that are intended for the benefit of investors. Most funds operate under the SEC 28e safe harbor rules that restrict soft dollar use to research only. |
| Unencumbered Cash | Unencumbered cash is equal to cash holdings less margin requirements. |