

CLIFFWATER<sup>LLC</sup>

INVESTMENT ADVISORY SERVICES

Los Angeles • New York

**Hedge Fund Operations Due Diligence Report  
Brigade Leveraged Capital Structures Fund, LP  
Brigade Leveraged Capital Structures Offshore, Ltd**

**June 2011**

*Investment Due Diligence Report provided under separate cover.*

### Hedge Fund Operations Due Diligence Report

<b>Firm Name:</b>	Brigade Capital Management, LLC		
<b>Fund Name:</b>	Brigade Leveraged Capital Structures Fund, LP Brigade Leveraged Capital Structures Offshore, Ltd		
<b>Style:</b>	Credit	<b>Location:</b>	New York, NY
<b>Review Date:</b>	June 28, 2011	<b>Reviewer:</b>	[REDACTED]

<b>Operations Score:</b> [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**

Brigade’s operational team and back office processes and procedures have remained very stable since Cliffwater’s last review in June 2010. However, the manager has implemented the below enhancements over the past year to further strengthen its overall non-investment infrastructure:

- [REDACTED] has been added as an additional prime brokerage relationship. The manager will utilize [REDACTED] predominantly as another resource for equity shorting and as an additional leverage point to manage rebate rates among their prime brokers.
- [REDACTED] have been added as new custodial relationships. Brigade will utilize these relationships to segregate fully paid for securities from the prime brokers.
- Compliance policies related to the prevention of insider trading have been updated to address the usage of expert consultants. Specifically, the manager now requires all analysts to read a script prior to any calls with consultants and the Chief Compliance Officer may occasionally listen in on these calls.
- The operations team recently hired a new analyst who will have a dedicated focus on the processing and monitoring of corporate actions.
- The manager has purchased a Directors and Officers (“D&O”) insurance policy which provides coverage for up to \$50mm.

The operational scores noted above remain unchanged since the June 2010 review.

Brigade's team of 29 non-investment professionals effectively manages all trading and business operations and meets nearly all industry operational best practices. Brigade could bring its procedures fully in line with best practices by excluding the portfolio manager from its valuation committee. Despite this departure from best practices, Brigade has made a substantial investment in its middle and back office infrastructure. The firm's overall trading volume is approximately 50 trades daily across a wide range of credit products. Brigade has developed strong trading, operations and risk processes and platforms to manage the variety of products and strategies. The operations and accounting teams are headed by experienced industry professionals and firm turnover has been minimal. Brigade maintains a focus on managing and reducing counterparty risk by reviewing exposures across its clearing and execution relationships on a regular basis. Mr. Patrick Kelly is a founder and the Chief Operating Officer who oversees all middle and back office functions.

**Section 1: Business Management**

**Score:** [REDACTED]

*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.*

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

Mr. Steven Vincent serves as the Chief Compliance Officer. Prior to coming to Brigade, he worked in the General Counsel's office at Goldman, Sachs & Co. for eight years. He is assisted by Aaron Daniels, who previously worked at Seward & Kissel LLP. The firm also hired [REDACTED] as a compliance consultant. A representative from [REDACTED] is at the manager's offices about two days each week to assist with routine compliance matters such as matching pre-approved personal trades to brokerage statements in addition to reviewing the compliance manual and internal e-mails. All employees are required to sign their adherence to the policies in the compliance manual on an annual basis. As noted above, Brigade has recently updated its compliance procedures to include specific policies related to the usage of expert networks, in addition to political contributions. All soft dollar usage falls with the safe harbor created by Section 28(e) of the US 1934 Securities and Exchange Act. There is a very restrictive personal trading policy. All trades must be pre-cleared and access persons cannot trade in a security that is currently held in the portfolio. A maximum of 60 personal trades are allowed per quarter and there is a required 60 day holding period. Employees must send brokerage statements which are reconciled by [REDACTED] and reviewed by the Chief Compliance Officer.

The firm recently added a D&O insurance policy and carries a \$50mm policy covering both D&O and E&O. The manager also has a key-man policy covering Don Morgan, the Managing Partner. Brigade has a detailed written disaster recovery plan which includes a dedicated hot site in [REDACTED]. All internal systems are backed up on a daily basis to this facility.

*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]	
Systems and platforms: [REDACTED]	
[REDACTED]	
Backup procedures: [REDACTED]	
Business continuity and disaster recovery plan: [REDACTED]	
Insurance coverage: [REDACTED]	

**Section 2: Trading and Investment Operations**

Score: [REDACTED]

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

[REDACTED] serves as the fund's administrator. [REDACTED] are the prime brokers. There are also custodial accounts established with [REDACTED]. The law firms of [REDACTED] are retained to advise the funds on domestic and Cayman legal matters, respectively, as needed.

The firm employs five execution-only traders. All trades to be executed must be authorized by either the managing partner or portfolio manager. The firm maintains an authorized broker/dealer list and traders

can only execute with the approved counterparties. The manager executes approximately 50 trades a day on average. On the day the trade is executed, the operations team confirms each trade with the counterparty. Every evening the manager sends a trade file from [REDACTED] the order management system, to [REDACTED] and the prime brokers. [REDACTED] will upload the information into their accounting system and conduct a full reconciliation with the counterparties and prime brokers the following day. The firm has an operations team dedicated to processing and maintaining bank loans. The firm trades both performing and distressed bank debt.

Any cash movements relating to trading requires signatures from two of the six authorized signatories, which includes the managing partner, portfolio manager, COO, CCO, CFO or controller. All other cash movements require two signatures from Brigade and two from the external administrator [REDACTED]. [REDACTED] also has additional cash controls.

*Best Practices Comparison*

Outside Service Providers		Yes	No
28	[REDACTED]		
29	[REDACTED]		
30	[REDACTED]		
Infrastructure			
31	[REDACTED]		
32	[REDACTED]		
33	[REDACTED]		
34	[REDACTED]		
35	[REDACTED]		
36	[REDACTED]		
Trading Practices			
37	[REDACTED]		
38	[REDACTED]		
39	[REDACTED]		
40	[REDACTED]		
41	[REDACTED]		
42	[REDACTED]		
43	[REDACTED]		
44	[REDACTED]		
45	[REDACTED]		
Core Accounting Processes			
46	[REDACTED]		
47	[REDACTED]		
48	[REDACTED]		
49	[REDACTED]		
50	[REDACTED]		
51	[REDACTED]		

Cash, Margin, and Collateral Management	
52	[REDACTED]
53	[REDACTED]
54	[REDACTED]
55	[REDACTED]
56	[REDACTED]

Entity and Contact	Onshore	Offshore
Prime Broker	[REDACTED]	
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?	[REDACTED]	

Criteria	Cliffwater Comments
Organizational Structure: [REDACTED]	[REDACTED]
Control structure and oversight [REDACTED]	
Trading team: [REDACTED]	
Types of securities traded [REDACTED]	
Trading practices: [REDACTED]	

Trade flow process: [Redacted]	[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]

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

The manager requires very minimal, if any, leverage at the portfolio level; therefore it obtains all the financing it may need via margin financing from the prime brokers and the leverage inherent under the ISDA master agreements. The manager seeks to mitigate counterparty risk by diversifying its counterparty exposure across highly rated banks. It also makes bi-lateral collateral calls on a daily basis. In addition, all of its prime brokers are onshore and all fully paid for and unencumbered assets are moved to custodial accounts. All excess cash is invested in US treasuries. For publically traded securities, the manager utilizes only onshore prime brokers.

*Best Practices Comparison*

Financing and Counterparty Risk		Yes	No
57	[Redacted]		
58			
59			
60			
61			



62	[REDACTED]
63	[REDACTED]
64	[REDACTED]
65	[REDACTED]

*Background*

Criteria	Cliffwater Comments
Sources of financing: [REDACTED]	[REDACTED]
Counterparties and terms of arrangements: [REDACTED]	
Prime broker financing: [REDACTED]	
Repo agreements [REDACTED]	
ISDAs [REDACTED]	
Other (i.e. CDOs, debt offerings, etc.) [REDACTED]	[REDACTED]

**Section 4: Valuation**

**Score:** [REDACTED]

Brigade meets nearly all valuation best practices. The one exception is that its valuation committee includes the portfolio manager. However, this does not seem to materially increase valuation risk because the majority of valuation committee members are non-investment professionals. The overall

valuation risk is relatively low because, [REDACTED]. The external administrator, SS&C Fund Services, values the portfolio at every month end. Reuters, IDC or Bloomberg pricing is used to value all exchange traded products and Markit is used to value the bank debt positions. Broker dealer quotes are generally used to value the non-exchange traded or illiquid securities. The manager will also value the portfolio independent of the administrator and then reconcile to [REDACTED]

As discussed above, the manager has formed a valuation committee to oversee the valuation process which includes the managing partner, portfolio manager, COO, CCO, head and co-head of trading and the CFO. The committee meets on a monthly basis and is focused on reviewing the valuations for the hard-to-value assets that require broker quotes or models for valuation.

*Best Practices Comparison*

Valuation Personnel		Yes	No
66	[REDACTED]		
67	[REDACTED]		
Valuation Policy			
68	[REDACTED]		
69	[REDACTED]		
70	[REDACTED]		
71	[REDACTED]		
72	[REDACTED]		
73	[REDACTED]		
74	[REDACTED]		
75	[REDACTED]		
76	[REDACTED]		
77	[REDACTED]		
78	[REDACTED]		
Pricing Sources and FAS 157 Companies			
79	[REDACTED]		
80	[REDACTED]		
81	[REDACTED]		
82	[REDACTED]		
83	[REDACTED]		
84	[REDACTED]		
85	[REDACTED]		
86	[REDACTED]		
87	[REDACTED]		
88	[REDACTED]		
Positions with No Readily Ascertainable Market Value			
89	[REDACTED]		
90	[REDACTED]		
91	[REDACTED]		
92	[REDACTED]		
93	[REDACTED]		
94	[REDACTED]		
Valuation Committee			
95	[REDACTED]		

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108	
109	

*Background*

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

**Section 5: Risk Management**

**Score:** [REDACTED]

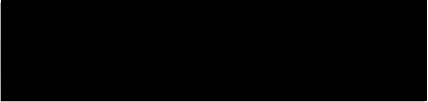
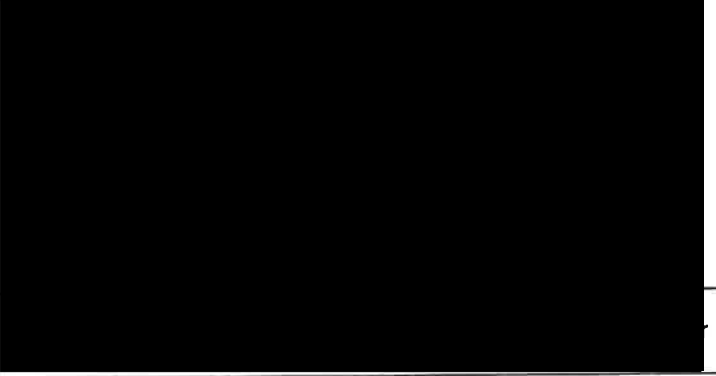
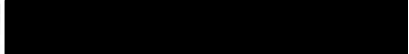
Brigade meets all risk management best practices. The risk management process is overseen by a six person risk management committee. The manager utilizes a proprietary risk management system to manage and oversee various risk components including stress testing, hedging and short borrows. Each member of the team has access to the risk analytics throughout the trading day. In addition, [REDACTED] and [REDACTED] reporting is available to investors. The manager limits leverage so that gross long or gross short exposure never exceeds 200% and the net exposure never exceeds 150%. In addition, net single position and net sector exposure cannot exceed 5% and 20% of the portfolio, respectively.

*Best Practices Comparison*

Structure	Yes	No
110	[REDACTED]	[REDACTED]
111	[REDACTED]	[REDACTED]
112	[REDACTED]	[REDACTED]

113	
114	
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116	
117	
118	
119	
<b>Risk Manager</b>	
120	
121	
122	
123	
124	
125	
<b>Risk Limits and Testing</b>	
126	
127	
128	
129	
130	
131	
<b>Leverage and Liquidity Risk</b>	
132	
133	
134	
135	
136	

*Background*

Criteria	Cliffwater Comments
Structure of risk management group: 	
Liquidity risk and funding: 	

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**Section 6: Investor Related Practices**

**Score:**

Brigade meets all disclosure and investor terms best practices. The PPM details the investment terms, fees, and conditions. The fees are calculated based on the audited financial statements and based on the dollar of value added. The lock-up and gate provisions protect the fund from having to liquidate the portfolio at a discount to meet investors redemptions.

Investors receive monthly, quarterly and annual letters from the manager.  will also send finalized NAV statements to investors by the seventh business day after each month end. Schedule K-1 tax information is typically sent to investors by March 15th. Position level transparency is available upon request with a one month lag. The firm also hosts semi-annual meetings and welcomes onsite reviews.

Brigade's financial statements are audited by  and audited financial statements are sent to investors within 90 calendar days of year end, which is slightly timelier than the industry standard.

*Best Practices Comparison*

Initial Disclosures		Yes	No
137			
138			
139			
140			
141			
142			
143			
144			
145			
Fees and Expenses			
146			
147			
148			
149			
150			
151			
Ongoing Information Provided to Investors			
152			
153			
154			
155			
156			

157	[REDACTED]
158	[REDACTED]
159	[REDACTED]
160	[REDACTED]
Financial Statement and Tax	
161	[REDACTED]
162	[REDACTED]
163	[REDACTED]
164	[REDACTED]
165	[REDACTED]
166	[REDACTED]
Investor Terms	
167	[REDACTED]
168	[REDACTED]
169	[REDACTED]
170	[REDACTED]

**Background**

Criteria	Cliffwater Comments
[REDACTED]	[REDACTED]
Fund financial and tax statements: [REDACTED]	[REDACTED]

**Meeting History**

Date	Location	Cliffwater Attendees	Manager Attendees
June 21, 2010	New York	[REDACTED]	Robert Brady (Director of Institutional Sales), Joseph Turilli (Associate), Raymond Luis, CPA, CFA (Chief Financial Officer), Patrick Kelly (President, Chief Operating Officer), Steven Vincent (Chief Administrative Officer and General Counsel), Patrick Criscillo, CPA (Controller)
June 28, 2011	New York	[REDACTED]	Robert Brady (Director of Institutional Sales), Steven Vincent (Chief Administrative Officer and General Counsel), Patrick Criscillo, CPA (Controller), Brett Honneus (CTO)

**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

	<i>transaction between market participants at the measurement date.</i> 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"> <li>The portfolio has 200% gross exposure (equal to \$200 gross notional exposure divided by \$100 NAV)</li> <li>The portfolio is one time (1x) levered (equal to \$100 in debt divided by \$100 NAV)</li> </ol> <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> <ul style="list-style-type: none"> <li><i>Equities</i> – the market value of long and short positions</li> <li><i>Corporate Debt and Municipal Bonds</i> – the market value of long and short positions</li> <li><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)</li> <li><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</li> <li><i>Credit Default Swaps</i> – total notional exposure of the underlying reference credit</li> <li><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</li> <li><i>Futures/Forwards</i> – total notional exposure to reference security or index</li> </ul>
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.