



INVESTMENT ADVISORY SERVICES

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Hedge Fund Operations Due Diligence Report

Mason Capital, Ltd

Mason Capital, LP

January 2011

Investment Due Diligence Report provided under separate cover.

Hedge Fund Operations Due Diligence Report

Firm Name:	Mason Capital Management, LLC		
Fund Name:	Mason Capital, Ltd Mason Capital, LP		
Style:	Event-driven	Location:	New York, NY
Review Date:	January 13, 2011	Reviewer:	██████████

Operations Score: ██████████			
1. Business Management	██████	4. Valuation	██████
2. Trading and Investment Operations	██████	5. Risk Management	██████
3. Financing and Counterparty Risk	██████	6. Investor Related Practices	██████

Summary

Mason's back office team has remained very stable over the past year since Cliffwater's last operational review in November 2009, however, it has made some changes to its processes and controls. The biggest change is that it finished moving all of its external administration funds from its former administrator, ██████████, to its new administrator ██████████. It completed this transition because the manager thought it would be simpler to work with only one administrator and it believed ██████████ offer a higher level of customer service than ██████████. The manager has also made the following additional changes:

- Overall trading volume has decreased to ██████████ from a historical average of approximately ██████████. The decrease in volume is because the market is less volatile than it was during the financial crisis and thus the book does not have to be rebalanced as frequently as it did during the crisis.
- Enhancing its prime brokerage relationship with ██████████ by using a new service called ██████████ which allows the manager to toggle positions back and forth between a margin account at ██████████ and a custodial account at ██████████. This gives the manager flexibility to quickly move fully-paid for and unencumbered longs into the safer custodial account quickly if it needed to but also to keep any securities that are undergoing corporate actions or serving as collateral for short positions in the traditional prime brokerage account.
- Finished negotiating an intermediation agreement with ██████████ in which most ISDA trades with other counterparties will be given up to ██████████. This will reduce the firm's counterparty risk because ██████████ is a higher-quality credit than most of its current counterparties.
- Tightened its wire transfer controls by lowering the threshold for wires which require two signatures from \$5 million to \$2 million.

Additionally over the next year the manager also plans to hire a new Chief Compliance Officer to take over the compliance functions which are currently handled by Mr. John Grizzetti and to prepare the firm for SEC registration. The manager believes it will be prepared to register well in advance of the July 2011 deadline and will not have to make any material changes to its compliance policy to meet SEC requirements.

Mason's team of eight non-investment professionals effectively manages all trading and business operations and meets most all industry operational best practices. Mason could bring its procedures fully in line with best practices by hiring an independent risk manager. Despite this departure from best practices, the manager has put in a place a comprehensive risk management program to monitor portfolio and operational risk. In addition, Mason has made a substantial investment in developing an institutional-quality infrastructure with a focus on creating a strong internal control environment and minimizing operational risk.

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.

The back office professionals have significant industry experience. The team is led by the CFO Mr. John Grizzetti who has served as a CFO for alternative investment advisors for more than 15 years.

Section 1: Business Management

Score:	
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Mason meets all best practices which assess firm organization, compliance, investor protections and disaster recovery.

As mentioned above, Mr. John Grizzetti is the Chief Compliance Officer and is responsible for ensuring the fund's policies are adhered to, monitoring personal trading, and filing regulatory reports as necessary. The firm has a comprehensive and detailed compliance manual which is available for review during onsite due diligence visits. It was developed in conjunction with the firm's primary external legal counsel [REDACTED]

[REDACTED] The firm is currently not an SEC Registered Investment Advisor. However, it has been registered in the past and its compliance policies are designed to meet SEC standards. An affiliate of the firm is registered with the FSA in the UK. Mason has also retained the law firm of [REDACTED] to do a mock SEC audit to ensure it is prepared if it needs to register with the SEC. All personal trading is monitored and must first be pre-approved by the compliance officer. Copies of staff trade confirmations and monthly brokerage statements are sent directly to the compliance officer.

The manager has outsourced most of its information technology functions to [REDACTED] who also is responsible for maintaining and testing their disaster recovery and data back-up facilities. As mentioned above, the London office serves as a back-up site which contains servers that replicate all critical data on a daily basis. In addition, there is a tape backup of all information on a weekly basis. The manager also carries professional liability insurance inclusive of an errors and omissions policy.

Best Practices Comparison

Organization and Governance		Yes	No
1			
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3			
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Compliance			
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Investor Protections			
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Disaster Recovery	
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27	

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

Section 2: Trading and Investment OperationsScore: ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐

Mason 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 administrator for the funds. [REDACTED] are the prime brokers and [REDACTED] also serves as a custodian. The law firms of [REDACTED] are retained to advise the funds as needed.

All orders are placed by one of the two senior portfolio managers, Messrs. Kenneth Garschina and Michael Martino, through the head trader, Mr. Michael Hamill. The head trader is execution-only and is allowed to trade only with authorization given by either portfolio manager. The manager typically executes only 5 to 10 trades a day and both the external administrator and Mason back office professionals reconcile all trades, positions, and cash on a daily basis. In addition, the majority of trades are confirmed on the day the trade is executed. Only the CFO and the two senior portfolio managers are authorized to move cash. All cash wires in excess of [REDACTED] require two signatures.

Best Practices Comparison

Outside Service Providers		Yes	No
28	[REDACTED]		
29	[REDACTED]		

30	
Infrastructure	
31	
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Trading Practices	
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45	
Core Accounting Processes	
46	
47	
48	
49	
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51	
Cash, Margin, and Collateral Management	
52	
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54	
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Entity and Contact	Onshore	Offshore
Prime Broker		
Administrator		
Audit		
Legal		
Tax		
Other (including custodian if not PB)		

Entity and Contact	Onshore	Offshore
Changes in providers (3 yrs)		
Any issues encountered in audit of firm or its products?		

Criteria	Cliffwater Comments
Organizational Structure: [REDACTED]	
Control structure and oversight [REDACTED]	
Trading team: [REDACTED]	
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]

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

The firm usually does not use leverage so it is able to obtain the financing it needs through margin financing with the prime brokers, trading instruments governed by ISDA master agreements, and entering into repurchase and reverse-repurchase agreements. The firm will fully pay for many of its long positions and has the ability to move them to [REDACTED] which is a custodial bank. The firm also occasionally enters into repurchase agreements to finance its fixed-income positions and will enter into reverse-repurchase agreements when it has excess unencumbered cash. It has also negotiated ISDA master agreements with eight major institutional banks. The firm trades only with major financial institutions and carefully monitors the financial health of its counterparties. It is also in the process of setting up a derivative prime brokerage arrangement ("intermediation agreement") with [REDACTED] to further reduce counterparty risk.

Best Practices Comparison

Financing and Counterparty Risk		Yes	No
57	[REDACTED]		
58			
59			
60			
61			
62			
63			
64			
65			

Background

Criteria	Cliffwater Comments
Sources of financing: [REDACTED]	[REDACTED]
Counterparties and terms of arrangements: [REDACTED]	
Prime broker financing: [REDACTED]	
Repo agreements [REDACTED]	

ISDAs		
Other (i.e. CDOs, debt offerings, etc.)		

Section 4: Valuation**Score:**

Mason meets all valuation best practices. The independent administrator is able to value 95% of the portfolio independent of the fund at every month end. At every month end, the accounting team will price the entire portfolio. They will send the values to the external administrator who will compare the manager-furnished marks to the valuations they have received independently from the pricing vendors, counterparties, and prime brokers. The administrator will discuss any material differences between the prices it receives from independent third-parties and the fund's price with the fund but in practice this rarely happens.

As of December 31, 2010, approximately 78% of the portfolio could be priced directly from an exchange via [REDACTED] or with multiple broker-dealer quotes from a liquid over-the-counter market such as the CDS market. The majority of the balance of the portfolio can be priced by soliciting quotations from broker dealers who make a market in the security or name. There is only one position which represents less than .27% of the portfolio and is a Level 3 security under FAS 157. Mason retains [REDACTED] value this position on a quarterly basis.

Best Practices Comparison

Valuation Personnel		Yes	No
66			
67			
Valuation Policy			
68			
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78			
Pricing Sources and FAS 157 Companies			
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Positions with No Readily Ascertainable Market Value	
89	
90	
91	
92	
93	
94	
Valuation Committee	
95	
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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:**

Mason meets all risk management best practices. Portfolio risk is primarily monitored by the senior portfolio managers Messrs. Kenneth Garschina and Michael Martino.

The geographic focus is primarily US, but can also include Europe, UK, and Asia if there are opportunities in those regions. Leverage is rarely used and the entire portfolio can be liquidated in four days without any market impact so the liquidity risk of the portfolio is minimal.

Best Practices Comparison

Structure		Yes	No
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111			
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119			
Risk Manager			
120			
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123			
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125			
Risk Limits and Testing			
126			
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128			
129			
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131			
Leverage and Liquidity Risk			
132			
133			
134			
135			
136			

Background

Criteria	
Structure of risk management group: [REDACTED]	[REDACTED]
Liquidity risk and funding: [REDACTED]	

Section 6: Investor Related Practices**Score:**

Mason 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.

A monthly “flash” estimate is usually distributed to investors by the first business day after month end. A final month end statement is usually available by the tenth business day. Quarterly conference calls occur within the first ten days after quarter end and a quarterly letter is sent within the 45 days after the quarter end. The fund is very transparent and is willing to discuss specific positions during monthly monitoring calls and onsite visits.

Mason’s financial statements are audited by [REDACTED] and audited financial statements are sent to investors by the beginning of April which is slightly timelier than the industry average. Schedule K-1 tax information is usually sent to investors by the middle of March which is also timelier than the industry average.

Best Practices Comparison

Initial Disclosures	Yes	No
137	[REDACTED]	[REDACTED]
138		
139		
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143		
144		
145		

Fees and Expenses	
146	
147	
148	
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151	
Ongoing Information Provided to Investors	
152	
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Financial Statement and Tax	
161	
162	
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Investor Terms	
167	
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Background

Criteria	Cliffwater Comments
Quality and frequency of reporting	
Fund financial and tax statements:	

Meeting History

Date	Location	Cliffwater Attendees	Manager Attendees
November 5, 2009	New York, NY	[REDACTED]	John Grizzetti (CFO)
January 13, 2011	New York, NY	[REDACTED]	John Grizzetti (CFO)

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 <i>"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."</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	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: - 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) 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: <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
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.