

CLIFFWATER<sup>LLC</sup>

INVESTMENT ADVISORY SERVICES

Los Angeles • New York

Hedge Fund Operations Due Diligence Report  
Third Point Offshore Fund Ltd  
Third Point Partners LP  
Third Point Partners Qualified LP

January 2011

*Investment Due Diligence Report provided under separate cover.*

### Hedge Fund Operations Due Diligence Report

<b>Firm Name:</b>	Third Point LLC		
<b>Fund Names:</b>	Third Point Offshore Fund Ltd Third Point Partners LP Third Point Partners Qualified LP		
<b>Style:</b>	Event Driven	<b>Location:</b>	New York, NY
<b>Review Date:</b>	January 21, 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**

Third Point's team of 27 non-investment professionals effectively manages all trading and business operations and meets most all industry operational best practices. Third Point could bring its procedures fully in line with best practices by installing a general ledger system to fully shadow the work of its administration and purchasing errors and omission insurance. However, the first departure is not seem to materially increase operational risk because the manager does keep all the portfolio information and carefully reviews all the administrator's calculations. For the second departure, the firm's preference is to self-insure for its instances of errors and omissions. Notwithstanding these departures from best practices, Third Point has institutional-quality processes and controls and has a very stable and experienced operational team.

**Section 1: Business Management**

**Score:** [REDACTED]

Third Point meets all best practices which assess firm organization, compliance, investor protections and disaster recover except that it does not have errors and omissions insurance. The manager has looked at policies in the past but has chosen to not purchase it because it believes that the policy does not add value for the investors because the premiums are too high for the level of protection the insurance company is providing.

Mr. [REDACTED] serves as the Chief Compliance Officer. Prior to coming to Third Point, he worked at the US Securities and Exchange Commission for several years. The manager has hired [REDACTED] to assist Mr. [REDACTED] with implementing the compliance program. The review the written compliance manual, help organize regular compliance training and assist Mr. [REDACTED] with all other compliance functions on an as needed basis. Third Point has a very restrictive personal trading policy which is outlined in the compliance manual. Generally, Employees can trade only in U.S. government obligations, cash equivalents, money market funds, open-end mutual funds, unit investment trust, investment grade corporate bonds, limited mortgage bonds, and private investments. The Chief Compliance Officer has the authority to approve other trades, but does so only in rare circumstances. Employees are required to send duplicate statements to the Chief Compliance Officer. The fund is a SEC Registered Investment Advisor and, thus, has adequate document retention policies. The manager does not use soft dollars but does receive some free services from brokers which fall within the 28(e) safe harbor. Its anti-money laundering procedures conform to the standards set out in Title III of the US PATRIOT Act of 2001.

*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.*

[REDACTED]

The fund has professional and investment liability insurance including D&O but not E&O as discussed above. In addition, the manager has formed a Business Continuity Committee and has a formal disaster recovery plan. The manager maintains a disaster recovery site in Centennial, CO. All information is backed up to the servers approximately every 15 minutes. The manager has also retained Symantec Backup Exec and Iron Mountain to make regular back-up tapes.

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

**Section 2: Trading and Investment Operations**

Score: [REDACTED]

Third Point meets almost all trading and investment operations best practices which assess outside service providers, infrastructure, trading and accounting processes, counterparty monitoring, and cash management except that it does not have a full in-house general ledger system. However, this does not seem to materially increase operational risk because on a daily basis the external administration will perform a full reconciliation of its internal books and records to Third Point's counterparties, prime brokers and custodians and to trade information from Third Point. It will then send the completed reconciliation to Third Point where it is reviewed by the operations team.

[REDACTED] serves as the fund's administrator. [REDACTED]

[REDACTED] serve as the prime brokers. The law firm of [REDACTED] is retained to advise the funds as needed.

Overall trade volume is very low with the manager executing only five to fifteen trades a day. The trading process is automated from the point of trade capture through the reconciliation which occurs the day after the trade is executed. Fully executed trades are entered into the proprietary trade capture system by the traders and confirmed by the operations group. This process includes using an automated allocation module to allocate bulk trades to the funds and prime brokers. The trades are then fed automatically into the [REDACTED] portfolio management system, a [REDACTED] product.

*Best Practices Comparison*

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

Infrastructure	
31	
32	
33	
34	
35	
36	

Trading Practices	
37	
38	
39	
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Core Accounting Processes	
46	
47	
48	
49	
50	
51	

Cash, Margin, and Collateral Management	
52	
53	
54	
55	
56	

Entity and Contact	Onshore	Offshore
Prime Broker		
Administrator		

Entity and Contact	Onshore	Offshore
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: [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:	

**Section 3: Financing and Counterparty Risk**

Score:

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

The fund's primary sources of financing are margin financing from prime brokers and ISDA master agreements. The manager typically has 30 to 90 day term financing with its prime brokers and it makes daily variation margin calls to minimize its counterparty risk. From time to time, the manager will enter into repurchase agreements to finance a portion of its fixed income book but that is not a material part of its financing plan.

*Best Practices Comparison*

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

*Background*

Criteria	Cliffwater Comments
Sources of financing:  <small>(with ISDA, repo, etc. financing, etc.)</small>	
Counterparties and terms of arrangements:	
Prime broker financing:	



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

**Section 4: Valuation**

Score:

Third Point meets all valuation best practices. Overall valuation risk is very low because as of December 31, 2010 less than [REDACTED] of the portfolio was classified as Level 3 under FAS 157. In addition, the manager has retained [REDACTED] to value the vast majority of all non-publically traded positions. Specifically, they value positions as of June 30<sup>th</sup> and December 31<sup>st</sup> for all manager-marked securities with a market value in excess of [REDACTED]

At every month end, the administration will value the portfolio and send a draft of the NAV to Third Point for review. The manager has formed a valuation committee which meets [REDACTED] to review and approve all valuations. [REDACTED] are the primary price sources used by [REDACTED] to value the portfolio. The trading desk will solicit indicative bids for positions that cannot be valued from these price sources, but the quotations will be sent directly to the administrator so they can verify the prices independent of the fund.

*Best Practices Comparison*

Valuation Personnel		Yes	No
66	[REDACTED]		
67	[REDACTED]		
Valuation Policy			
68	[REDACTED]		
69	[REDACTED]		
70	[REDACTED]		
71	[REDACTED]		
72	[REDACTED]		

73	
74	
75	
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Pricing Sources and FAS 157 Companies	
79	
80	
81	
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83	
84	
85	
86	
87	
88	
Positions with No Readily Ascertainable Market Value	
89	
90	
91	
92	
93	
94	
Valuation Committee	
95	
96	
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107	
108	
109	

*Background*

Criteria	Cliffwater Comments
Month end closing process	

Valuation of exchange traded (level 1) assets: <div style="background-color: black; width: 100%; height: 20px;"></div>	
Valuation of OTC / illiquid instruments / private placement (level 2 and 3) assets <div style="background-color: black; width: 100%; height: 40px;"></div>	

**Section 5: Risk Management**

**Score:** [REDACTED]

Third Point meets all risk management best practices. [REDACTED] serves as the Chief Risk Officer. To monitor risk he uses a number of risk management metrics including portfolio volatility, drawdown, VaR, and risk adjusted exposure. Most metrics are calculated on a real time basis using an internal developed risk system. In addition, the senior investment committee meets on a daily basis to evaluate the overall leverage and risk of the firm. The manager sometimes uses long dated options to hedge out exposures to avoid catastrophic risk. The manager also has liquidity caps that limit the position sizes based on market liquidity to ensure its ability to liquidate its positions quickly and manageably (i.e. without drastically moving market prices).

*Best Practices Comparison*

Structure	Yes	No
110		
111		
112		
113		
114		
115		
116		
117		
118		
119		
Risk Manager		
120		

121	[REDACTED]
122	[REDACTED]
123	[REDACTED]
124	[REDACTED]
125	[REDACTED]
Risk Limits and Testing	
126	[REDACTED]
127	[REDACTED]
128	[REDACTED]
129	[REDACTED]
130	[REDACTED]
131	[REDACTED]
Leverage and Liquidity Risk	
132	[REDACTED]
133	[REDACTED]
134	[REDACTED]
135	[REDACTED]
136	[REDACTED]

*Background*

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

**Section 6: Investor Related Practices**

**Score:** [REDACTED]

Third Point 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.

All investors receive detailed risk exposures and attribution on a monthly basis. In addition, they receive monthly statements directly from the administrator. Portfolio managers are also available for periodic meetings upon request.

Third Point's financial statements are audited by [REDACTED] and audited financial statements are sent to investors within 120 calendar days of year end, which is slightly timelier than the industry standard. Schedule K-1s are usually sent to investors in early April.

*Best Practices Comparison*

Initial Disclosures		Yes	No
137	[REDACTED]		
138	[REDACTED]		
139	[REDACTED]		
140	[REDACTED]		
141	[REDACTED]		
142	[REDACTED]		
143	[REDACTED]		
144	[REDACTED]		
145	[REDACTED]		
Fees and Expenses			
146	[REDACTED]		
147	[REDACTED]		
148	[REDACTED]		
149	[REDACTED]		
150	[REDACTED]		
151	[REDACTED]		
Ongoing Information Provided to Investors			
152	[REDACTED]		
153	[REDACTED]		
154	[REDACTED]		
155	[REDACTED]		
156	[REDACTED]		
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
<ul style="list-style-type: none"> <li>Quality and frequency of reporting</li> </ul>	[REDACTED]
Fund financial and tax statements:	[REDACTED]

**Meeting History**

Date	Location	Cliffwater Attendees	Manager Attendees
January 21, 2011	New York, NY	[REDACTED]	[REDACTED]

**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	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: <ol style="list-style-type: none"> <li>The portfolio has 200% gross exposure (equal to \$200 gross notional exposure divided by \$100 NAV)</li> </ol>

	<p>b. 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:</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.