

Item 1. Cover Page



# **AVENUE CREDIT MANAGEMENT, L.P.**

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## **FORM ADV PART 2**

January 17, 2017

**This brochure provides information about the qualifications and business practices of Avenue Credit Management, L.P. If you have any questions about the contents of this brochure, please contact Eric Ross, Senior Managing Director and Chief Compliance Officer, at (212) 878-3500 or [eross@avenuecapital.com](mailto:eross@avenuecapital.com).**

**The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority. Registration as an investment adviser with the SEC does not imply a certain level of skill or training.**

**Additional information about Avenue Credit Management, L.P. is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

## **Item 2. Material Changes**

This brochure represents Avenue Credit Management, L.P.'s first Form ADV Part 2A. As a result, there are no material changes to report.

This brochure should be reviewed in its entirety.

### Item 3. Table of Contents

	<u>Page</u>
Item 2. Material Changes .....	i
Item 3. Table of Contents.....	ii
Item 4. Advisory Business .....	1
Structure; History and Ownership.....	1
Types of Advisory Services .....	2
Assets Under Management .....	2
Item 5. Fees and Compensation .....	2
Fees .....	2
Expenses .....	3
<b>Funds</b> .....	3
<b>Separately Managed Accounts</b> .....	7
Item 6. Performance-Based Fees and Side-by-Side Management .....	7
Item 7. Types of Clients.....	7
Item 8. Methods of Analysis, Investment Strategies and Risk of Loss.....	8
Methods of Analysis and Investment Strategies .....	8
<b>Credit Strategy</b> .....	9
Risks Associated with the Firm’s Investment Strategies .....	10
<b>Conflicts of Interest</b> .....	10
<b>Risks Related to Our Investment Strategies</b> .....	15
Item 9. Disciplinary Information .....	38
Item 10. Other Financial Industry Activities and Affiliations .....	39
Material Financial Industry Affiliations of the Firm.....	39
Other Activities.....	43
Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading.....	44
Code of Ethics; Personal Trading .....	44
Participation or Interest in Client Transactions.....	45
Item 12. Brokerage Practices .....	47
Selection of Brokers.....	47
Soft Dollar and Directed Brokerage Arrangements .....	48
Aggregation of Orders .....	48
Allocation Procedures .....	48
Trade Errors and Net Asset Value Computation Errors.....	50

Item 13. Review of Accounts.....	51
Item 14. Client Referrals and Other Compensation .....	51
Compensation for Client Referrals; Placement Agents and Distributors for Funds .....	51
Item 15. Custody .....	51
Item 16. Investment Discretion .....	51
Item 17. Voting Client Securities.....	51
Proxy Voting .....	52
Corporate Actions .....	52
Conflict Resolution in Proxy Voting and Corporate Actions .....	53
Class Actions .....	53
Item 18. Financial Information .....	53

## **Item 4. Advisory Business**

### **Structure; History and Ownership**

Avenue Credit Management, L.P. (the “firm”) is an investment adviser with its principal place of business in New York City. The firm provides investment advisory services to private investment funds (“funds”). In addition to our offices in New York, affiliates of the firm have offices in London, Luxembourg, Madrid, Milan, Munich, Sydney, Hong Kong, Beijing, Delhi and Singapore.

This brochure provides information about: (i) the firm and (ii) general partners or managing members of the firm’s fund clients and other affiliated entities that are relying on the firm’s registration as an investment adviser (in accordance with the U.S. Securities and Exchange Commission (“SEC”) letter to the American Bar Association, Subcommittee on Private Investment Entities dated December 8, 2005 (the “2005 SEC Letter”)), which are listed in Section 7.A. of Schedule D in Part 1A of the firm’s Form ADV. Each such entity conducts its activities in accordance with the Investment Advisers Act of 1940, as amended (the “Advisers Act”), and the rules thereunder, and is subject to the supervision and control of the firm, including being subject to the firm’s investment adviser compliance policies and procedures.

The firm expects to become registered as an investment adviser with the SEC as of January 2017.

The firm, its affiliated SEC-registered investment advisers (Avenue Capital Management II, L.P. (CRD #111845), Avenue Europe International Management, L.P. (CRD #131937) and Avenue Asia Capital Management, L.P. (CRD #113246) and the general partners and managing members of the firm’s fund clients are part of Avenue Capital Group (“Avenue” or “Avenue Capital”), a global alternative investment firm founded in 1995. As of December 31, 2016, Avenue Capital had approximately 200 employees worldwide, including 65 investment professionals. Avenue Capital maintains a well-developed infrastructure with extensive accounting, operations, legal, investor relations, risk management, compliance and information technology teams.

Marc Lasry (Chairman, Chief Executive Officer and Co-Founder) and Sonia Gardner (President, Managing Partner and Co-Founder) are the Senior Principals of the firm and together control the general partner of the firm, Avenue Credit Management GenPar, LLC. Richard Furst is the Chief Investment Officer of Avenue Capital and spends a portion of his time providing high-level investment oversight globally, including to the firm. Jane Castle is a Portfolio Manager and is responsible for the firm’s Credit strategy focusing on portfolio companies headquartered or with principal places of business in North America and up to 20% in geographic locations anywhere else in the world.

Our primary investment advisory service is to provide discretionary investment advice to funds. In addition to the funds, we may also advise separately managed accounts on a discretionary basis. The objective and strategy of a managed account may but is not required to be similar to the investment objective and strategy of a fund managed by the firm.

Avenue Capital’s primary focus is investing in credit obligations (public and private), including without limitation, distressed debt and equity opportunities, other special situations and high yield investments in the United States, Europe and Asia. Avenue Capital’s primary advisory service is to provide discretionary investment advice to private funds and registered investment companies (“public funds”). The Senior Principals and the Portfolio Manager of the funds managed by the firm have spent virtually their entire careers in this space.

The firm generally pursues a theme-driven, concentrated investment strategy that is analytically intensive and relies upon individual issuer, industry and macro research and analysis. To execute this strategy, the firm has assembled an experienced team of investment professionals. The depth of experience of these professionals allows for thorough research and analysis of potential investment opportunities, including issuers with complicated, multi-layered capital structures in complex and dynamic industries.

The funds we advise are expected to employ the firm's Credit strategy.

Prospective investors in any fund are advised to review the fund's offering documents for a more in-depth description of that fund's investment strategy and objectives, types of assets to be invested in, investment restrictions (if any) and related risk factors.

A list of the funds we manage can be found below at Item 10.

### **Types of Advisory Services**

As described above, we provide advisory services to funds and separately managed accounts for institutional investors. Neither the firm nor any of our affiliates is acting as an investment adviser or otherwise making any recommendation as to an investor's decision to invest in the funds. The advisory services we provide to investment funds are provided on a discretionary basis. The advisory services we provide to managed accounts may be discretionary or non-discretionary.

The investment strategies that we employ on behalf of our clients are described below at Item 8.

### **Assets Under Management**

As of the date of this filing, we do not have any discretionary or non-discretionary assets under management.

## **Item 5. Fees and Compensation**

### **Fees**

Detailed information regarding fees is included in each fund's offering documents. Because this brochure will only be delivered to "qualified purchasers" investing in our funds, as defined in section 2(a)(51) of the Investment Company Act of 1940, a complete description of our compensation arrangements is not required to be included in this brochure. Fees paid for services provided to managed accounts are determined on a client-by-client basis and may, but are not required to, be substantially similar to those paid by funds.

The funds we advise generally pay management fees and incentive allocations or carried interest, depending upon each fund's investment strategy. Management fees for funds, calculated as a percentage of the asset value or aggregate (or drawn but unreturned) commitments of the fund attributable to each investor, are generally paid monthly, quarterly or semi-annually in advance. With respect to our funds that pay us a carried interest, management fees are *pro rated* for partial periods in the event that our investment management agreement with the fund is terminated or an investor makes a capital contribution or purchases shares at any time other than at the beginning of a fund's valuation period, but are payable in full for partial periods resulting from distribution of fund assets. With respect to our funds that pay us an incentive allocation, management fees are *pro rated* for partial periods.

Incentive allocations or carried interest are calculated as a percentage of profits of the funds. Some funds pay incentive allocations, in whole or in part, on mark-to-market performance at the end of a period (year-end or upon a partial or full withdrawal), subject to a high watermark. Other funds pay a carried interest on realized returns. For those funds, such carried interest payments are not paid to us until investors receive 100% of their capital back plus a preferred return.

Management fees, incentive allocations and carried interest rates may be negotiable.

For more information regarding certain categories of fee income, including without limitation, break-up fees, please see Item 5 under the heading “Fees and Compensation – Expenses – Funds.”

## **Expenses**

Whether an expense is a fund or firm expense shall be determined jointly by the Chief Compliance Officer and Chief Financial Officer, with the assistance of such other parties as they deem necessary. Expense allocation determinations may be made as to broad categories or expense types or on an expense item-by-expense item basis. How an expense is allocated as between funds and the firm shall be documented by the applicable Controllers and consistently applied thereafter.

If permitted under a fund’s controlling documents, from time to time the management company may advance payment of an expense on behalf of the fund and to the extent that the expense may be appropriately borne by the funds, the management company may seek reimbursement from the funds.

Once a determination is made that an expense is a fund expense that is attributable to more than one fund, the Chief Compliance Officer and Chief Financial Officer, with the assistance of such other parties as they deem necessary, shall determine the appropriate allocation methodology among the funds. For instance, research that generally could benefit any fund within a strategy or among strategies may be allocated among such funds/strategies based on the funds’ strategies’ respective net asset values or in such other manner as the firm deems equitable among the funds. Other expenses that directly relate to a specific investment may be allocated based on how the investment is held by, or is to be allocated to, the funds. There may be situations where an expense may be allocable to some but not all of the funds that receive the benefit of such expense. In these situations, the funds that can bear the expense shall bear their allocable share of the expense and the firm shall pay the remainder.

## **Funds**

The payment of expenses by a fund will reduce the value of each investor’s investment in the fund.

Detailed information regarding the expenses to which each fund is subject is set out in the offering documents with respect to the particular fund.

Fund expenses may include, without limitation, the following categories of expenses:

- formation expenses of the fund and related entities, including fees and expenses of counsel to, accountants for and agents of the fund, its general partner, if applicable, and the firm, of personnel of the firm and its advisors, and other expenses (including, without limitation, travel and travel-related costs and expenses (including business class airfare and first class airfare)), in each case, incurred in connection with the formation and marketing of the fund and related entities, the preparation of the fund’s operative documents and the offering of equity interests of the fund;

- audit fees and other out-of-pocket expenses incurred in connection with the preparation and distribution of financial statements for the fund, any portfolio company or special purpose vehicles used by the fund with respect to any investment, audit and reporting compliance;
- expenses incurred in connection with the evaluation, acquisition or disposition of investments (whether or not consummated), including:
  - private placement fees,
  - sales commissions,
  - appraisal fees,
  - taxes,
  - brokerage fees,
  - underwriting commissions and discounts,
  - travel and travel-related expenses (including business and first-class airfare);
  - legal, accounting, investment banking, consulting fees (including without limitation, fees payable to expert network consultants) and professional fees;
  - research-related fees and expenses;
  - data and information service providers (*e.g.*, Bloomberg, Debtwire, general market research with respect to trading models and industries, etc.); and
  - other transaction costs.
- a fund's allocable share of costs and expenses incurred in respect of any proposed investments that are not consummated and that were not intended by the general partner to support any investment previously made by the fund such that the general partner determines that such expenses should be considered investment expenses with respect to such investment previously made, including, without limitation, fees and expenses incurred to obtain financing commitments and fees and expenses paid to legal counsel, accountants or experts retained to negotiate or document a proposed investment or to conduct due diligence reviews, in each case to the extent that with respect to any such proposed investment (i) such out-of-pocket costs and expenses are not otherwise reimbursed by an unaffiliated third party or by the subject of the proposed investment, and (ii) the proposed investment is not consummated by an affiliate of the fund nor does any such affiliate receive any material amount of compensation in connection with the consummation of such proposed investment from any person other than the fund;
- compensation and other similar expenses of consultants (including industry executives, advisors, consultants, operating executives, subject matter experts or other persons acting in a similar capacity (including with respect to potential portfolio investments));
- any costs and expenses incurred in connection with the carrying or management of investments, including:
  - custodial, trustee, record keeping and other administration fees;



- expenses incurred in connection with the preparation and distribution of its tax returns, financial statements and reporting for the fund (including Schedules K-1 for fund investors);
- expenses incurred in connection with tax compliance (including FATCA compliance);
- attorneys' and accountants' fees and disbursements relating to fund matters;
- taxes and other governmental charges levied against it;
- any and all expenses (including legal fees and expenses) incurred to comply with any law or regulation related to the activities of the fund (including regulatory expenses of the general partner, if any, and the firm incurred in connection with reporting to regulatory authorities and preparation and making of any required regulatory filings or notice (including Form PF, U.S. Bureau of Economic Analysis or Federal Reserve Board forms, AIFMD, FATCA (including without limitation, FATCA expenses related to investor due diligence, reporting, filings fees, and registration), U.K. FATCA, CRS or similar regulatory filings)) or otherwise incurred in connection with any litigation or governmental inquiry related to the activities of the fund (to the extent such expenses would be indemnifiable under the fund's operative documents), including filing and registration fees and expenses related to regulatory sweeps;
- insurance premiums and other insurance costs and expenses incurred in connection with the activities of the fund, including without limitation, errors, omissions, fidelity, crime, general partner liability, directors' and officers' liability and similar coverage for any indemnified party;
- expenses incurred in connection with its dissolution, liquidation or winding-up and termination;
- expenses relating to defaults by investors in the payment of any capital contributions;
- expenses for transactions not consummated;
- expenses incurred in connection with any restructuring or amendments to a fund's constituent documents and related entities;
- expenses incurred in connection with the formation of alternative investment vehicles to the extent permitted under the fund's constituent documents;
- expenses incurred in connection with the formation, maintenance and operation of special purpose vehicles through which the fund makes, holds or manages investments (including Luxembourg or other vehicles), including:
  - rent,
  - employee costs,
  - office expenses,
  - administrator fees and
  - professional fees incurred with respect to tax planning and tax compliance;

- expenses of any administrator of the fund and any special purpose vehicles through which the fund makes, holds or manages investments (including Luxembourg or other vehicles);
- expenses incurred in connection with distributions to investors;
- expenses incurred in connection with any meetings with investors called by the fund's general partner (including any annual conferences), including travel (including business class airfare, or when business class is not available, first class airfare), meal and lodging expenses of the fund's advisory board and professionals of the investment adviser incurred in connection with attending such meetings;
- expenses incurred in connection with the preparation and distribution of any investor communications (including Intralinks);
- expenses related to the fund's indemnification obligations;
- certain litigation expenses;
- any amounts paid by the fund for, or resulting from, hedging transactions;
- investment management fees;
- expenses incurred in connection with compliance with side letters;
- expenses relating to transfers of interests in the fund or a permitted withdrawal of an investor (but only to the extent not paid or otherwise borne by the withdrawing investor and/or the assignee of the withdrawing investor);
- out-of-pocket expenses incurred by members of an advisory committee in connection with the fulfillment of their duties, including without limitation, travel expenses incurred in connection with attending advisory committee meetings (including, without limitation, transportation, meal and lodging expenses, including business class airfare, or when business class is not available, first class airfare);
- any principal, interest on and fees and expenses arising out of, the fund's borrowings and indebtedness (including, without limitation, the fees, and costs and expenses incurred in obtaining lines of credit, loan commitments and letters of credit for the account of the fund);
- the structuring fee under a total return swap or any credit facility;
- the cost and expenses associated with a total return swap or any credit facility
- other extraordinary expenses relating to the fund and its activities that are not investment expenses; and
- such other expenses as are set forth in the fund's private placement memorandum, limited partnership agreement and/or other operative documents.

Fee income, including commitment fees, break-up fees, directors' fees and similar income realized with respect to investments or proposed investments by a fund, will first be applied to unreimbursed out-of-pocket expenses related to the applicable transaction; any excess amount will be used to reduce the applicable investment management fee otherwise payable by the fund's investors by an identical amount,

or, at our discretion, be paid directly to the fund. Notwithstanding the foregoing, such fees (including directors' fees) may be waived at our discretion.

### ***Separately Managed Accounts***

The expenses borne by separately managed accounts are set forth in their agreements with us and generally include all custodial fees, brokerage commissions, clearing fees, interest and withholding or transfer taxes incurred in connection with trading for the client's account.

For more information regarding our brokerage practices and brokerage expenses that may be incurred, please see Item 12.

## **Item 6. Performance-Based Fees and Side-by-Side Management**

As discussed in Item 5 above, the funds we advise generally pay incentive allocations or carried interest, depending upon the fund's structure. Incentive allocations or carried interest are calculated as a percentage of profits of the funds. Some funds pay incentive allocations, in whole or in part, on mark-to-market performance at the end of a period (year-end or upon a partial or full withdrawal), subject to a high watermark. Other funds pay a carried interest on realized returns. In those funds, such carried interest payments are not paid to us until investors receive 100% of their capital back plus a preferred return. Incentive allocations and carried interest rates may be negotiable.

We have a fiduciary duty to our clients not to favor the account of one client over that of another, without regard to the types and amounts of fees paid by those accounts. In light of this, we have allocation and other policies and procedures in place to ensure that accounts are treated fairly. We seek to allocate investments among funds with similar strategies that are managed by the same investment team on a *pro rata* basis, targeted net asset basis or targeted total asset basis. However, as described in Item 12, under the heading "Allocation Procedures," there are a number of reasons for which a particular transaction may not be allocated on a *pro rata* basis.

Avenue Capital Management II, L.P., an affiliate of the firm, serves as adviser to registered investment companies under the Investment Company Act of 1940 (*i.e.*, public funds), in addition to private funds. The public funds advised by Avenue Capital Management II, L.P. do not pay a performance fee. The public funds may invest in securities that are the same as or similar to certain investments that may be held in certain of our private funds (which do pay a performance fee). For more information regarding the allocation of investments between Avenue Capital's public and private funds, see Item 12 under the heading "Allocation Procedures."

## **Item 7. Types of Clients**

We serve as the investment manager of, and provide investment advisory services to, private investment funds and managed accounts. Neither the firm nor any of our affiliates is acting as an investment adviser or otherwise making any recommendation as to an investor's decision to invest in the funds. With respect to the funds, investment advice is provided directly to the funds and not individually to each of the funds' limited partners or shareholders, as applicable. With respect to the managed accounts, the investment objective and strategy of each client will not involve a recommendation or determination by us as to the appropriate investment program for such client nor due diligence by us as to such client's financial condition or risk profile.

The funds' investors may consist of one or more of the following: individuals, pension and profit sharing plans, financial institutions (including funds of funds), trusts, endowments, charitable organizations and corporations or other business entities.

Each fund investor or managed account client is required:

- to be an "Accredited Investor" as such term is defined in Rule 501(a) of Regulation D under the Securities Act of 1933;
- to be a "Qualified Client" as such term is defined in SEC Rule 205-3 under the Investment Advisers Act of 1940;
- to be a "Qualified Purchaser" as such term is defined in Section 2(a)(51) of the Investment Company Act of 1940; and
- to meet such other eligibility requirements as we determine on a case by case basis.

Managed account clients may consist of one or more of the following: individuals, pension and profit sharing plans, financial institutions (including funds of funds), trusts, endowments, charitable organizations and corporations or other business entities.

There is no minimum size for the funds or managed accounts we advise. We expect a majority of the funds managed by the firm to have minimum investment amounts ranging from \$5,000,000 to \$10,000,000. Certain funds, however, may have higher or lower minimum investment amounts depending upon the agreement negotiated between the firm and a fund's investor(s), particularly in the case of single investor funds. Subject to applicable statutory minimums, such minimum investment amounts are negotiable.

## **Item 8. Methods of Analysis, Investment Strategies and Risk of Loss**

### **Methods of Analysis and Investment Strategies**

We pursue a theme-driven, concentrated investment strategy that is analytically intensive and relies upon individual issuer, industry and macro research and analysis. In addition to conducting extensive fundamental issuer analysis, we may actively participate on creditors' committees and steering committees. For those companies that require a restructuring (in or out of court), we may seek to influence and/or actively drive the reorganization, bankruptcy or restructuring process. Our goal is to select industries that are undergoing periods of rapid change and/or deterioration, which may provide significant investment opportunities as these cycles run their course. Following a disciplined, theme-based strategy allows us to pursue a relatively concentrated portfolio with a limited number of core investments. This results in a portfolio that represents a careful selection of investments within such industries rather than a broader, "indexed" approach. We employ a value investing strategy based on fundamental, proprietary research and comprehensive due diligence. Our due diligence process seeks to uncover hidden value and/or risk, thereby increasing potential returns and reducing the risk of investment loss.

The firm employs a Credit investment strategy on behalf of the funds it manages, which may include investments in one or more of the following investment categories:

- Distressed;
- High Yield;

- Real Estate; and
- Private Equity.

Funds may use one or more special purpose vehicles to effect a fund investment or in such circumstances as the firm may deem appropriate, including in an effort to increase the tax efficiency of a fund investment or to enable compliance with local investment laws. Expenses related to the creation and maintenance of these special purpose vehicles, including, among other things, rent, salaries, equipment and insurance, will be borne by the funds.

All funds have the ability to use security-level leverage in respect of their investments, and certain of our funds invest in asset classes (derivatives and options) that include implicit leverage. As a general matter, most of our funds do not use fund-level leverage as part of their investment strategy(ies), although each fund has the authority to do so. For a detailed description of the specific leverage restrictions with respect to a fund and/or the manner in which leverage may be employed by a fund, please refer to that fund's offering documents. See Item 8 "Methods of Analysis, Investment Strategies and Risk of Loss – Risks Associated with the Firm's Investment Strategies – Use of Leverage."

Our investment strategy and certain risks associated with our investment strategy are described in this Item 8. Prospective investors in any fund(s) are advised to review the respective funds' offering documents for a more in-depth description of that fund's investment strategy and objectives, types of assets to be invested in, investment restrictions (if any) and related risk factors.

### ***Credit Strategy***

The firm's Credit strategy focuses on the distressed debt and undervalued securities of portfolio companies headquartered or with principal places of business in North America and up to 20% in geographic locations anywhere else in the world. As a general matter, the Credit strategy may also invest in real estate debt or equity.

The strategy generally focuses on investments in the debt, equity or other securities, including indebtedness or other obligations, of:

- companies in financial distress or undergoing a turnaround;
- companies in bankruptcy, reorganization or liquidation;
- companies in industries that are in turmoil;
- companies that are undervalued because of discrete extraordinary events; and
- companies whose securities the firm believes to be undervalued.

The Credit strategy generally targets:

- bank debt;
- event-driven situations;
- trade claims;
- distressed securities;

- derivatives;
- high-yield debt; and
- restructured and post-reorganization equities.

When investing in the distressed debt and undervalued securities of companies, the firm seeks “good companies with bad balance sheets” - firms with sustainable businesses and positive cash flow but whose financial situation may be problematic. The firm typically does not seek to gain operational control of companies we invest in, but we may have operational control of such companies from time to time. The firm focuses on pre-investment research and analysis and post-investment monitoring, rather than post-investment operating issues.

Investments are generally expected to be made in senior secured debt or other debt that is structurally senior to other portions of the capital structure. However, as market cycles evolve, the Credit strategy may seek to invest in more junior portions of the capital structure depending on the risk return profiles of an investment.

In addition, the funds that employ our Credit strategy may act as lenders originating floating rate and fixed rate loans.

As a general matter, we do not use fund-level leverage as part of our Credit strategy, although we may in the future, but we do invest in asset classes (derivatives and options) that include implicit leverage.

In addition to focusing on distressed investments, the firm’s Credit strategy seeks to generate a high level of current income and capital appreciation by opportunistically investing primarily in credit obligations, including senior secured floating rate and fixed rate loans and high yield bonds (including non-investment grade bonds, speculative grade bonds and junk bonds) of issuers which operate in a variety of industries, and in companies that we believe have strong leadership, stable cash flow and improving credit performance. As a result, the firm’s Credit strategy is expected to focus on investments in senior secured debt or other debt that is structurally senior to other portions of the capital structure for purposes of financing or refinancing investment opportunities. However, as market cycles evolve, we may seek to invest in more junior portions of the capital structure, depending on the risk return profile of the investment.

Prospective investors in any of our funds employing our Credit strategy are advised to review the fund’s offering documents for a more in-depth description of that fund’s investment strategy and objectives, types of assets to be invested in, investment restrictions (if any) and related risk factors.

## **Risks Associated with the Firm’s Investment Strategies**

The investment strategies described above that we use for the funds cover a wide range of investment types. Material risks involved in our investment strategies are described below. Prospective investors in any fund are advised to review the fund’s offering documents for a more in-depth description of that fund’s risk factors.

### ***Conflicts of Interest***

An investment in a fund or managed account involves certain potential conflicts of interest, including those described below.

**Other Clients.** In addition to responsibilities with respect to the management and investment activities of any particular fund or managed account, the firm will have similar responsibilities with respect to various other existing and future pooled investment vehicles and client accounts. The existence of such multiple vehicles and accounts necessarily creates a number of potential conflicts of interest.

**Investment Activities of Funds and Other Clients; Allocation of Investment Opportunities Among Funds and Other Clients.** The firm conducts the various funds' investment programs in a manner that is similar to the investment programs of other clients, particularly where the investment objectives and policies of various clients overlap. As a result, there may be conflicts between clients with respect to the allocation of investment opportunities. See Item 12 ("Brokerage Practices") below for a description of how the firm addresses such potential or actual conflicts.

**Combined Orders; Nominee Arrangements.** If the firm has determined to invest at the same time for one or more clients, the firm will generally place combined orders for all such accounts simultaneously and if all such orders are not filled at the same price, it will generally average the prices paid. Similarly, if an order on behalf of more than one fund or client cannot be fully executed under prevailing market conditions, the firm will allocate the investments among the different funds or clients on a basis that it considers equitable. Situations may occur where a fund or client could be disadvantaged because of the investment activities conducted for other funds or clients. A fund may also serve as a nominee or hold securities as a nominee for the other Avenue funds and any other client that is participating in an investment alongside the fund.

**Time Commitment.** The firm and its affiliates are not obligated to devote any specific amount of time to the affairs of any fund or managed account. The firm's affiliates spend substantial time on other business activities, including those related to the other Avenue clients (as defined herein). The firm's Senior Principals and their affiliates currently engage in and will be free to continue to engage in outside business activities as well as investment activities for their own accounts.

**Agreements with Certain Investors in Funds.** The funds, the firm and their respective affiliates have and may from time to time in the future enter into agreements with one or more investors whereby in consideration for agreeing to invest certain amounts in a fund and other consideration deemed material to the fund, such investors may be granted rights not otherwise afforded to other investors, including, without limitation, the right to receive reports from the fund on a more frequent basis or to receive reports that include information not provided to other investors, the right to pay a reduced carried interest and/or investment management fee, the right to receive a share of the carried interest and/or investment management fee earned by the firm or its affiliate and such other rights as may be negotiated between the funds, the firm and their respective affiliates, on the one hand, and such investor, on the other hand. Such agreements will have the effect of establishing rights under, or altering or supplementing the terms of, the fund's constituent documents with respect to such investors. To the extent that the firm reasonably believes that compliance with any of the provisions of any such agreements would cause the funds, the firm or any of their respective affiliates to violate their respective fiduciary duties or obligations or to violate any applicable laws, any non-compliance with any such provision will not be deemed to be a breach of such agreements.

**Agreements with Certain Managed Account Clients.** The firm may, and its respective affiliates do, provide advice to one or more managed accounts. These managed accounts invest side-by-side (*i.e.*, in parallel) with one or more of the funds managed by that affiliate and may invest alongside the funds we manage. The agreements entered into with managed account clients grant rights not afforded to other clients or to fund investors. Such rights may, and in certain cases do, include, without limitation, increased transparency (*e.g.*, the right to receive reports regarding the managed account on a more frequent basis or to receive reports that include information not provided to other clients or fund

investors), the right to withdraw capital on a more frequent basis than other clients or fund investors, the right to terminate the managed account on short notice and such other rights as may be negotiated between the firm and its respective affiliates, on the one hand, and such client, on the other hand. In addition, the fees and expenses paid by managed account clients may be less, in some cases substantially less, than those paid by other clients or by the funds and the investors in the funds. These managed accounts may seek to liquidate investments upon termination of their respective investment management agreements in situations where the firm may be unable to liquidate the account's portfolio holdings and/or where the liquidation of the account's portfolio holdings is not in the best interest of the firm's other clients. To the extent that the firm reasonably believes that compliance with any of the provisions of any managed account agreement would cause the firm or any of its respective affiliates to violate its respective fiduciary duties or obligations or to violate any applicable laws, any non-compliance with any such provision will not be deemed to be a breach of such agreements.

**Transactions with Affiliates.** A client may engage in transactions with the firm or its affiliates. The firm may cause a fund or managed account to engage in cross trades. Such transaction will be on terms no less advantageous to the fund than are available from unaffiliated persons.

The firm may cause a fund to engage in cross-trades, typically for purposes of rebalancing the portfolios of the fund or for other reasons consistent with the investment and operating guidelines of the fund. In such circumstances, if the Senior Principals and their affiliates determine in good faith that the transaction is in the best interest of the fund and each such other client, the instruments may be transferred at market value between the fund and such other client(s). However, the Senior Principals and their affiliates will not receive a commission directly or indirectly in connection with such cross-trade.

From time to time, the firm, on behalf of a fund, may receive offers to purchase certain assignments of, or participations in, loans or notes (or interests therein) which clients of the firm own (including loans in whose origination such clients or the firm may have been involved). In the event of such an offer, the price of the participation or assignment of the loan or notes (or interest therein) will not solely be set by the firm or the fund but rather will be established based on third-party valuations obtained in accordance with the procedures followed by the fund, applied on a consistent basis. In connection with each such proposed transaction, the firm will prepare the materials it deems necessary to describe the transaction to the fund. The decision to accept or decline the offer, at the price offered, will, however, be made by a separate committee which will be retained by the fund and will consist of one or more members, after a review of the materials prepared by the firm regarding the proposed transaction plus any additional information requested by the committee. The committee will consist of one or more persons with substantial experience and knowledge of the loan market and related investment arenas who are independent of the firm. The initial member or members of the committee will be appointed by the firm. Following such initial appointment, if all members of the committee subsequently resign or are otherwise removed, the firm may appoint one or more additional members thereto.

**Related Party Transactions.** An advisory committee will have the right to, on behalf of investors and funds, approve or disapprove, certain related party transactions and any other matter as to which approval may be required under the Advisers Act, including Sections 205(a) and 206(3) thereof. In no event will any such transaction be entered into unless it complies with applicable law.

**Discounted Products and Services from Portfolio Companies.** Certain portfolio companies may offer product and service discounts from time to time to employees of the firm and its affiliates. For example, in order to encourage greater knowledge and understanding of their products and services, or as a general matter for friends and family, certain hospitality-related portfolio companies of a fund and other clients from time to time provide discounted hotel room rates to employees of the firm and its affiliates.



**Valuation.** The investment professionals of the firm, including the portfolio managers of a fund, may provide input during the valuation process, including, without limitation, at the valuation committee meetings. Such investment professionals maintain an interest in the valuation of a fund's assets. However, such investment professionals, including the portfolio managers of the fund, shall not participate in the final determination of the valuation of the fund's assets.

**Investments Involving Other Clients.** A client may, from time to time, make an investment in a portfolio company in which one or more other clients invests in a different part of the capital structure. There may be instances where such a portfolio company may become insolvent or bankrupt and where a fund's and the firm's other clients' interests in such portfolio company may conflict. Moreover, there may be situations in which a fund determines to invest in an issuer in which another fund managed by the firm or its affiliate(s) maintains an investment, so long as the firm or its affiliate(s) determine that the investment made by the fund(s) is appropriate for, and falls within the investment guidelines of, such fund(s). Furthermore, a fund may invest in the interests of another fund managed by the firm and/or its affiliate(s). To the extent that a fund holds securities in a portfolio company with rights, preferences and privileges that are different than those held by other clients in the same portfolio company, the firm and its affiliates may be presented with decisions when the interests of a fund and the firm's other clients are in conflict. It is possible that in a bankruptcy proceeding, out-of-court restructuring or other corporate action, a fund's interest may be subordinated, restricted in some manner or otherwise adversely affected by virtue of the firm's other clients' involvement and actions relating to its investment including, without limitation, the inability to conduct a transaction in an issuer or an instrument in a fund at a time when the firm would otherwise seek to conduct such transaction. There may be conflicts between clients with respect to voting the securities of such issuers and other matters relating to various investments. See Item 11 ("Code of Ethics, Participation or Interest in Client Transactions and Personal Trading – Participation or Interest in Client Transactions") and Item 17 ("Voting Client Securities") for a description of how the firm addresses such potential or actual conflicts.

**Follow-On Investments.** The funds may be called upon to make investments in an existing portfolio company (or any of its affiliates or subsidiaries) that in the general partner's determination is necessary to preserve, protect or enhance the value of an existing investment in such portfolio company. There can be no assurance that the funds will be able to make such investments, including, among other reasons, because the funds will have sufficient funds to do so or because the fund's offering documents prohibit such investment. Any decision not to make such investment could potentially have a substantial negative impact on an investment in a portfolio company. Moreover, to the extent that a fund does not make such investment in a company, such company may seek capital from other investors. Any such arrangements with other investors could rank senior to, and/or cause the dilution of, or otherwise negatively impact, the investment of the fund. In addition, the firm may determine to make a follow-on investment in a portfolio company in which one or more funds previously invested using assets from one or more new funds so long as the firm determines that the follow-on investment made by the new fund(s) is appropriate for, and falls within the investment guidelines of, such fund(s), notwithstanding that the new investment will have rights, preferences and privileges that are senior to the existing investment.

**Diverse Investment Management Firm.** The firm and the other investment managers that make up Avenue engage in a broad range of investment management activities, including sponsoring and managing other pooled investment vehicles, client accounts and other activities. Although the relationships and activities of the Avenue managers should enable these entities to offer attractive opportunities and services to their clients, such relationships and activities, in the ordinary course of business, may also give rise to circumstances in which the interests of these entities and other affiliates of the Avenue managers conflict with the interests of certain of Avenue's clients, including, without limitation, competition with other investment vehicles (proprietary or third-party managed) in which clients may have an interest, purchasing and selling investments in entities in which clients may have an

interest, or taking or advocating positions in certain transactions that may be considered adverse to the interests of certain clients. The Avenue managers effectively may engage in opposite transactions with respect to a particular investment (*e.g.*, one Avenue client may acquire a long position in a security on behalf of an Avenue client while one or more of the other Avenue clients sells or shorts the security).

**Other Activities.** Except for a dedicated team within Avenue Europe International Management, L.P. who are responsible for managing funds that employ the Direct Lending sub-strategy, the firm and its affiliates are not required to manage the investments of any particular client as their sole and exclusive function and each may engage in other business ventures and other activities unrelated to the affairs of any client, including directly or indirectly purchasing, selling, holding or otherwise dealing with any securities for the account of other investment funds, for their own accounts or for the accounts of family members or other clients. Without limiting the foregoing, the firm's Senior Principals and employees, including the Portfolio Manager, may invest in, participate on advisory boards of and/or provide other services to, funds that are unaffiliated with the firm and its family of funds. The firm and its Senior Principals and employees, including the Portfolio Manager, may become aware of business opportunities in which clients will not be given an opportunity to participate.

**Investment Management Fee; Incentive Allocation and/or Carried Interest.** The investment management fees and the incentive allocations or carried interest borne by funds have generally not been established on the basis of an arm's-length negotiation between the fund, on the one hand, and the firm or its affiliates, on the other hand. However, the firm believes that the investment management fees, and the terms of the incentive allocations or carried interest, generally reflect prevailing market terms. The existence of an incentive allocation or carried interest may create an incentive for the firm to cause a fund to make, more speculative investments than it would otherwise make in the absence of such performance-based compensation. In addition, the investment management fees for some of our funds that are structured like private equity funds may be charged on capital contributions that have not yet been invested or redistributed. Other private equity structured funds pay management fees on drawn capital only, which may create an incentive for a fund to draw down capital more quickly.

Although an incentive allocation or carried interest, such as is paid to the general partners of certain of our funds, has largely become a customary standard for private investment funds, this type of relative allocation of profits and losses can be characterized as creating an incentive to the general partner for speculative investment and thus a potential conflict with the interests of the limited partners. In addition, since the incentive allocation of certain of our funds (our private funds) is based upon portfolio gains, both realized and unrealized (net of realized and unrealized losses), it is possible that the general partner may receive an incentive allocation based upon unrealized appreciation in particular positions that was not in fact achieved upon disposition of such positions. Further, while the general partner is entitled to receive an incentive allocation based upon the realized and unrealized net profits initially allocated to each limited partner, it is allocated net losses solely on the basis of its invested capital.

For more information regarding certain categories of fee income, including without limitation, break-up fees, please see Item 5 under the heading "Fees and Compensation – Expenses – Funds."

**Diverse Investors.** Each fund's investors may include taxable and tax-exempt entities and persons or entities resident of or organized in various jurisdictions. As a result, conflicts of interest may arise in connection with decisions made by the firm or an affiliate that may be more beneficial for one type of investor. In making such decisions, the firm and its affiliates intend to consider the investment objectives of the fund as a whole, not the investment objectives of any investor individually.

**Minority Investor in Avenue Capital.** In the ordinary course of a fund's investment activities, from time to time the fund may enter into transactions with parties related to Morgan Stanley, which is a minority investor in certain entities that are part of Avenue Capital. Such transactions may include, among other

things, consulting services, prime brokerage, custodial and ISDA counterparty services and/or the fund purchasing securities from, or settling trades with, a party related to Morgan Stanley.

**Tax Risks.** The funds and/or investors could become subject to additional or unforeseen taxation in jurisdictions in which the funds operate and invest. Changes to taxation treaties (or their interpretation) between the U.S. and the countries in which the funds invest may adversely affect the funds' ability to efficiently realize income or capital gains.

There are a number of uncertainties in the tax laws relating to certain distressed assets. There can be no assurance that the position adopted by the funds with respect to the characterization of a particular distressed asset, or the timing and characterization of income and losses associated with such asset, will be respected by the IRS or a court, or the taxing authorities in other countries, and any recharacterization by such authorities, if successful, could adversely affect the investors' investments in the funds.

**European Union Alternative Investment Fund Managers Directive.** The European Union Directive on Alternative Investment Fund Managers (2011/61/EU) (the "AIFMD") applies to the firm to the extent to which it actively markets the funds into each member of the European Union that has implemented the AIFMD. If the funds are marketed to European Union-based investors, (i) they will be subject to certain reporting, disclosure and other compliance obligations under the AIFMD, which may result in the funds incurring additional costs and expenses; and (ii) compliance with AIFMD will also restrict certain activities of the funds in relation to portfolio companies based in the European Union, including, in some circumstances, the funds' ability to recapitalize, refinance or potentially restructure a European Union-based portfolio company within the first two years of ownership.

**Exit of the United Kingdom from the European Union.** On June 23, 2016, the United Kingdom held a remain-or-leave referendum on the United Kingdom's membership of the European Union, the result of which favored the exit of the United Kingdom from the European Union ("Brexit"). A process of negotiation will determine the future terms of the United Kingdom's relationship with the European Union, as well as whether the United Kingdom will be able to continue to benefit from the European Union's free trade and similar agreements. Depending on the terms of Brexit, economic conditions in the United Kingdom, the European Union and global markets may be adversely affected by reduced growth and volatility. The uncertainty before, during and after the period of negotiation – the timing of which is unknown – is also expected to have a negative economic impact and increase volatility in the markets, particularly in the United Kingdom and the Eurozone. Such negative economic impact and volatility could, in turn, adversely affect market conditions. In addition, the political and economic instability in the United Kingdom and other European countries, particularly countries in the Eurozone, could adversely affect the funds' investments.

Brexit may impact the regulatory framework applicable to the operations of the funds, including anticipated regulatory reform. For instance, under AIFMD, the introduction of marketing "passports" in respect of non-European Union alternative investment fund managers ("non-EU AIFM") that are registered in one member state of the European Union, which would enable the non-EU AIFM to market units or shares in the relevant alternative investment funds in other member states, may well be delayed and not in place by 2018 as required by the AIFMD. Any changes to the regulatory framework may impact the regulatory requirements imposed on the funds and increase the costs of operating and managing the funds and certain of their investments.

### ***Risks Related to Our Investment Strategies***

### **Risks Associated With Market Conditions And Investment Opportunities**

**General Economic Conditions and Recent Events.** Various sectors of the global financial markets have been experiencing an extended period of adverse conditions. In recent years, market uncertainty in the United States has increased dramatically and adverse market conditions have expanded to other markets. These conditions have resulted in reduced liquidity, greater volatility, general widening of credit spreads and a lack of price transparency. These difficult global credit market conditions have adversely affected the market values of equity, fixed-income and other securities and these circumstances may continue or even deteriorate further. The short- and longer-term impact of these events is uncertain, but could have a material effect on general economic conditions, consumer and business confidence and market liquidity. Investments made by a fund are expected to be sensitive to the performance of the overall economy. A negative impact on economic fundamentals and consumer and business confidence would likely increase market volatility and reduce liquidity, both of which could have a material adverse effect on the performance of a fund and these or similar events may affect the ability of a fund to execute its investment strategies.

**Economic and Political Risks of Investments in the United States, Europe and Asia.** A portion of the assets of one or more funds managed by the firm may invest in the United States, Europe and/or Asia. There is often a high degree of government regulation in the economies of the United States, Europe and Asia, including in the securities markets. Action by such governments may directly affect foreign investment in securities in those countries and may also have a significant indirect effect on the market prices of securities and of the payment of dividends and interest.

Changes in policy with regard to taxation, fiscal and monetary policies, repatriation of profits and other economic regulations are possible, any of which could have an adverse effect on the funds' investments. The economies of the United States, Europe and Asia may differ favorably or unfavorably from each other and other economies with regard to the rate of growth of gross domestic product, the rate of inflation, capital reinvestment, resource self-sufficiency and balance of payments. The U.S. government and governments in certain of the countries in Europe and Asia participate to a significant degree, through ownership interests or regulation, in their respective economies. Action by these governments could have a significant adverse effect on market prices of securities and payment of dividends. The economies of certain countries depend heavily on international trade and can be adversely affected by the enactment of trade barriers or changes in the economic conditions of their trading partners. With respect to certain countries, there may be the possibility of expropriation or confiscatory taxation, political, economic or social instability, limitation on the removal of funds or other assets or the repatriation of profits, restrictions on investment opportunities, the imposition of trading controls, withholding or other taxes on interest, capital gain or other income, import duties or other protectionist measures, various laws enacted for the protection of creditors, greater risks of nationalization or diplomatic developments which could adversely affect the investments or interests of the fund in those countries.

Changing political environments, regulatory restrictions, and changes in government institutions and policies in the United States, Europe and Asia could adversely affect private investments. Civil unrest, ethnic conflict or regional hostilities may contribute to instability in the United States and some countries of Europe and Asia. Such instability may impede business activity and adversely affect the environment for foreign investments. We do not intend to obtain political risk insurance on behalf of the funds. Actions in the future of the U.S. government and/or one or more European and Asian governments could have a significant effect on the various economies, which could affect market conditions, prices and yields of securities in a fund's portfolio. Political and economic instability in the United States and any of the countries in Europe or Asia in which a fund invests could adversely affect the fund's investments.

Laws affecting international investment and business in the United States, Europe and Asia also continue to evolve, although at times in an uncertain manner that may not coincide with local or accepted international practices. Laws and regulations, particularly those concerning investment and taxation, can

change quickly and unpredictably. Inconsistencies and discrepancies among the vast number of local, regional and national laws, the lack of judicial or legislative guidance on unclear or conflicting laws and broad discretion on the part of government authorities implementing the laws produce additional legal uncertainties. The burden of complying with changing and conflicting laws may have an adverse impact on the operations of the funds.

**Market Disruptions.** The funds may incur major losses in the event of market disruptions and other extraordinary events in which historical pricing relationships (on which we base a number of the funds' trading positions) become materially distorted. The risk of loss from pricing distortions is compounded by the fact that in disrupted markets many positions become illiquid, making it difficult or impossible to close out positions against which the markets are moving. Certain of Avenue's previous investments have benefited from favorable borrowing conditions in the debt markets, which historically have been cyclical. The financing available to the funds from their banks, dealers and other counterparties is typically reduced during market disruptions. Market disruptions caused by unexpected political, military and terrorist events may from time to time cause dramatic losses for the funds and such events can result in otherwise historically low-risk strategies performing with unprecedented volatility and risk.

**Availability of Suitable Investments.** While we believe that many attractive investments of the type in which the funds invest are currently available, there can be no assurance that such investments will continue to be available or that available investments will continue to meet the funds' investment criteria. Furthermore, the funds may be unable to find a sufficient number of attractive investment opportunities to meet their investment objectives. Past performance is not necessarily indicative of future performance.

**Competition.** The markets for potential investments in the funds' investment programs are highly competitive. The funds will be competing for investment opportunities with a significant number of financial institutions and other private funds as well as various institutional investors. Some of these competitors are larger and have greater financial, human and other resources than the funds and may in certain circumstances have a competitive advantage over the funds. As a result of this competition, there may be fewer attractively priced investment opportunities than in the past, which could have an adverse impact on the ability of the funds to meet their investment goals or the length of time that is required for the funds to become fully invested. There can be no assurance that the returns on any funds' investments will be commensurate with the risk of investment in the funds.

**No Assurance of Investment Return.** The funds' task of identifying and evaluating investment opportunities, managing such investments and realizing a significant return for investors is difficult. Many organizations operated by persons of competence and integrity have been unable to make, manage and realize a profit on such investments successfully. Avenue believes that its investment strategy and investment approach moderate this risk through a careful selection of securities and other financial instruments. However, there is no assurance that the funds will be able to invest their capital on attractive terms or generate returns for their investors. Investors in the funds could experience losses on their investment, including a total loss of their investment.

## **Risks Associated with the Firm's Investments and Investment Activities**

**Nature of Investments.** Our investment strategy involves investing in senior and subordinated, secured or unsecured, debt obligations, securities and assets that are inefficiently priced as a result of business, financial, market or legal uncertainties. The level of analytical sophistication, both financial and legal, necessary for successful returns on such investments is unusually high. There can be no assurance that we will evaluate correctly the nature and magnitude of the various factors that could affect the value of these investments.

In particular, the funds will purchase securities and other obligations of companies that are experiencing significant financial or business distress, including companies involved in bankruptcy or other reorganization and liquidation proceedings. Many of these securities typically remain unpaid unless and until the company reorganizes and/or emerges from bankruptcy proceedings. In addition, it frequently may be difficult to obtain information as to the conditions of these securities. The market prices of these securities are also subject to abrupt and erratic market movements and above average price volatility, and the spread between the bid and asked prices of such securities may be greater than normally expected. Although such investments may result in significant returns to the funds, they involve a substantial degree of risk and may not show any return for a considerable period of time, if at all.

Distressed investment opportunities can occur in companies that have filed for, or plan to file for, reorganization. Sourcing, diligence, structuring and governance of private distressed investments require consideration of factors that are often not present in standard private equity investing or investments in the senior and secured debt of financially sound companies. If our evaluation of the anticipated outcome of an investment situation should prove incorrect, the funds could experience losses. Successful investing requires a specialized skill set that includes:

- the capacity to accurately value a company's assets and analyze its capital structure;
- a sophisticated knowledge of the complex legal environment in which such investing occurs, particularly bankruptcy, securities, corporate and indenture law;
- the experience necessary to determine accurately the financial interests and legal rights of the debtor and each of its creditor constituencies; and
- refined negotiating skills.

A wide variety of considerations makes any evaluation of the outcome of an investment in a financially distressed company uncertain. These considerations include the possibility of litigation between the participants in a reorganization or liquidation proceeding or a requirement to obtain consents from governmental authorities or others, as well as numerous other factors. In addition, we may not have access to reliable and timely information concerning material developments affecting a company. The uncertainties inherent in evaluating such investments may be increased by legal and practical considerations which limit our access to reliable and timely information concerning material developments affecting an investment, or which cause lengthy delays in the completion of a reorganization or liquidation proceeding. Competition from other investors may also render it unadvisable for us to pursue intended results or promptly effect transactions.

Troubled company and other asset-based investments require active monitoring and will, at times, require participation in business strategy or reorganization proceedings by Avenue. To the extent that Avenue becomes involved in such proceedings, the funds may have a more active participation in the affairs of the issuer. In addition, involvement by Avenue in a company's reorganization proceedings could result in the imposition of restrictions limiting a fund's ability to liquidate its position in the securities of the company.

A portion of the funds' investments may be in obligations or securities that are rated below investment grade by recognized rating services such as Moody's and Standard & Poor's. Securities rated below investment grade and unrated securities generally offer a higher current yield than that available from higher grade issues but typically involve greater risk. The value of securities rated below investment grade and unrated securities is typically sensitive to adverse changes in general economic conditions and changes in the financial condition of their issuers and subject to price fluctuation in response to changes in these conditions or in interest rates. During periods of economic downturn or rising interest rates, issuers of securities rated below investment grade and unrated instruments may experience financial stress that could adversely affect their ability to make payments of principal and interest and increase the possibility of default. Adverse publicity and investor perceptions, whether or not based on fundamental analysis, may also decrease the values and liquidity of securities rated below investment grade and unrated securities, especially in a market characterized by a low volume of trading. In addition, the secondary market for high yield securities, which is concentrated in relatively few market makers, may not be as liquid as the secondary market for more highly rated securities. As a result, the funds could find it more difficult to sell these securities or may be able to sell the securities only at prices lower than if such securities were widely traded. The prices quoted by different dealers may vary significantly, and the spread between the bid and asked price is generally much larger for high yield securities than for higher quality instruments. Under continuing adverse market or economic conditions, the secondary market for high-yield securities could contract further, independent of any specific adverse changes in the condition of a particular issuer, and these securities may become illiquid.

To the extent that a secondary market does exist for debt obligations, including senior secured floating rate and fixed rate loans and subordinated or unsecured loans, the market is more volatile than for liquid, listed securities and may be subject to irregular trading activity, wide bid/ask spreads and extended trade settlement periods. Markets for other investments of the funds, including derivative instruments, bonds, currencies and other instruments can also be highly volatile. Purchasers of leveraged loans are predominantly commercial banks, investment funds and investment banks. As secondary market trading volumes increase, arrangers and obligors of new leveraged loans are frequently adopting standardized documentation to facilitate trading that should improve market liquidity. There can be no assurance, however, that the current level of liquidity will continue or that future levels of supply and demand in leveraged loan trading will provide an adequate degree of liquidity. No assurance can be given that a fund that purchases a leveraged loan will be able to sell that loan if the obligor has deteriorated in credit quality. Even in the absence of a default with respect to any leveraged loan, due to potential market volatility, the market value of such loan at any time will vary, and may vary substantially, from the price at which such loan was initially purchased and from the principal amount of such loan. The market value of leveraged loans will generally fluctuate with, among other things, the financial condition of the obligors of the loans, general economic conditions, the condition of certain financial markets, political events, developments or trends in any particular industry and changes in prevailing interest rates. No assurance can be given as to the amount of proceeds of any sale or disposition of any leveraged loan, or that the proceeds of any such sale or disposition would be sufficient to repay principal of and interest or other amounts due on the notes that may have been issued by a fund using such leveraged loan as collateral, and/or pay other amounts payable prior thereto.

The funds may invest in securities which are subject to legal or other restrictions on transfer or for which no liquid market exists, or acquire illiquid securities, *e.g.*, through bankruptcy reorganization proceedings. The sale of restricted and illiquid securities often requires more time and results in higher brokerage charges or dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in the over-the-counter markets. Restricted securities may sell at a price lower than similar securities that are not subject to restrictions on resale. Because the markets for such securities are still evolving, liquidity in these securities is limited and liquidity with respect to lower-rated and unrated subordinated classes may be even more limited. The funds may be unable to liquidate

all or a portion of their positions in such securities. In addition, the market prices, if any, for such securities tend to be more volatile and the funds may not be able to realize what it perceives to be their fair value in the event of a sale. The high yield securities markets have suffered periods of extreme illiquidity for certain types of instruments in the past. For these reasons, among others, calculating the fair market value of the funds' holdings may be difficult. The funds may, in their discretion, utilize the assistance of internal or external pricing services or valuation sources in calculating such fair market values when and if available.

If market quotations for the funds' investments are not readily available, the funds may seek to value their investments by modeling and other methods to fair value such investments, either through third-party service providers or by the firm's valuation team and by the firm's valuation committee, which has been charged with the responsibility of valuing the funds' portfolios. Illiquid securities are subject to wide spreads. Fair valuation is not exact and prices can vary significantly from one period to the next.

Debt investments are subject to credit and interest rate risks. "Credit risk" refers to the likelihood that an issuer will default in the payment of principal and/or interest on an instrument and that an investor may not receive any or all of its principal or interest. Financial strength and solvency of an issuer are the primary factors influencing credit risk. In addition, lack or inadequacy of collateral or credit enhancement for a debt instrument may affect its credit risk. Credit risk may change over the life of an instrument, and debt obligations, which are rated by rating agencies, are often reviewed and may be subject to downgrade. Senior loans, like most other debt obligations, are subject to credit risks of default. In addition, because second lien or other subordinated or unsecured loans or debt are subordinated in payment and/or lower in lien priority to senior loans, they are subject to additional risk that the cash flow of the borrower and property securing the loan or debt, if any, may be insufficient to meet scheduled payments after giving effect to the senior secured obligations of the borrower. This risk is generally higher for subordinated unsecured loans or debt, which are not backed by a security interest in any specific collateral.

"Interest rate risk" refers to the risks associated with market changes in interest rates. Interest rate changes may affect the value of a debt instrument indirectly (especially in the case of fixed rate debt securities) and directly (especially in the case of debt instruments whose rates are adjustable). In general, rising interest rates will negatively impact the price of a fixed rate debt instrument and falling interest rates will have a positive effect on price. Adjustable rate instruments also react to interest rate changes in a similar manner although generally to a lesser degree (depending, however, on the characteristics of the reset terms, including the index chosen, frequency of reset and reset caps or floors, among other factors). Interest rate sensitivity is generally more pronounced and less predictable in instruments with uncertain payment or prepayment schedules. In addition, interest rate increases generally will increase the interest carrying costs to the funds of borrowed securities and leveraged investments (*e.g.*, derivative transactions). If interest rates fall, it is possible that issuers of fixed income securities with high interest rates will prepay or "call" their securities before their maturity dates. In this event, the proceeds from the prepaid or called securities would likely be reinvested in securities bearing the new, lower interest rates, resulting in a possible decline in the funds' income.

In addition, the funds may agree to buy or sell bank claims or other similar private paper, with an understanding that formal written contracts for the purchase or sale will be prepared at a later date. The terms of these contracts may be less favorable than the funds anticipated. In some circumstances, they may be so unfavorable that a fund decides to terminate a proposed transaction.

The funds may from time to time make investments in securities of private companies without an active trading market. Traditional exit opportunities for such investments have consisted primarily of initial public offerings and acquisitions of portfolio companies by publicly traded companies, often for stock.



The ability of the funds to sell securities and realize investment gains will depend upon favorable market conditions. Initial public offering and merger and acquisition opportunities may be limited or non-existent for extended periods of time, whether due to economic, regulatory, or other factors. In addition, general fluctuations in the market prices of securities may affect the value of the investments held by the funds. Therefore, there is no assurance that the funds will be able to realize liquidity for such investments in a timely manner, if at all.

In recent years, markets for debt instruments have become noticeably less liquid. This “liquidity squeeze” reflects a growing structural change in financial markets that has resulted from industry consolidation, increased capital requirements, and stricter regulatory oversight of large banks that have traditionally served to “make” markets for debt securities through proprietary trading of short-term positions. The origins of reduced liquidity can be traced to the 2008-2009 financial crisis, which led to the disappearance of large firms such as Lehman Brothers and Bear Stearns, passage of the Dodd-Frank Act, and increased capital requirements related to Basel III standards. These factors have limited the number of market participants and reduced the profitability and extent of proprietary trading. While banks’ trading operations previously included dedicated proprietary trading desks that were designed to generate profits based on market or security-specific views, such operations have generally been curtailed. Remaining dealer trading operations are designed with a more narrow focus on facilitating trades through taking temporary positions in securities, which is a more limited use of banks’ proprietary capital. The decline in liquidity of the debt markets may lead to higher transaction costs for fund investments, and at the margins, increase the risk associated with debt investments held by the funds, particularly for lower-quality and more thinly traded issues.

The funds’ investments may also be adversely affected by changes in economic conditions or political events that are beyond their or our control. For example, a market crash, a war, or the death of a major political figure may have significant adverse effects on the funds’ investment results.

**Nature of Bankruptcy and Similar Proceedings.** There are a number of significant risks when investing in companies involved in bankruptcy cases, including the following:

- Many events in a bankruptcy case are the product of contested matters and adversary proceedings that are beyond the control of the creditors. While creditors are generally given an opportunity to object to significant actions, there can be no assurance that a bankruptcy court in the exercise of its broad powers would not approve actions that would be contrary to the interests of the funds. Further, positions based on established bankruptcy case law may prove to be incorrect.
- A bankruptcy filing may have adverse and permanent effects on a company. For instance, the company may lose its market position and key employees and otherwise become incapable of restoring itself as a viable entity. Further, if the reorganization case becomes a liquidation, the liquidation value of the company may not equal the liquidation value that was believed to exist at the time of the investment.
- The duration of a bankruptcy case is difficult to predict. A creditor’s return on investments can be adversely impacted by delays while the plan of reorganization is being negotiated, voted on by the creditors and confirmed by the bankruptcy court, until it ultimately becomes effective.
- The administrative costs in connection with a bankruptcy case are frequently high and may be paid out of the debtor’s estate prior to any return to creditors. Reorganizations can be contentious and adversarial. It is by no means unusual for participants to use the threat of, as well as actual, litigation as a negotiating technique. We anticipate that Avenue and/or the

funds may be named as defendants in civil proceedings. For example, if a proceeding involves protracted or difficult litigation, or turns into a liquidation, substantial assets may be devoted to administrative costs.

- Creditors can be subject to equitable subordination and lose their ranking and priority if they engage in certain inequitable conduct or they exercise “domination and control” over a debtor and other creditors can demonstrate that they have been harmed by such actions, especially in the case of investments made prior to the commencement of bankruptcy cases.
- Bankruptcy law in certain jurisdictions permits the classification of “substantially similar” claims in determining the classification of claims in a reorganization. Because the standard for classification is vague, there exists the risk that a fund’s influence with respect to the class of securities or other obligations it owns can be lost by increases in the number and amount of claims in that class or by different classification and treatment.
- In the early stages of the bankruptcy case, it is often difficult to estimate the extent of, or even to identify, any contingent claims that may be made.
- Certain claims, such as claims for taxes, may have priority by law over the claims of certain creditors.
- If a fund seeks representation on creditor’s committees, it may owe certain obligations generally to all similarly situated creditors that the committee represents and it may be subject to various trading or confidentiality restrictions. As the funds will indemnify any person serving on a committee or the board of directors on its behalf for claims arising from breaches of those obligations, indemnification obligations could adversely affect the return on any investment related to a reorganization.
- Certain Asian jurisdictions may present different risks.

**Concentration.** Because a significant portion of a fund’s aggregate capital commitments may be invested in a single company, any single loss may have a significant adverse impact on the fund’s capital. Accordingly, the fund’s assets may be subject to greater risk of loss than if they were more widely diversified since the failure of one or a limited number of investments could have a material adverse effect on the fund. The funds are subject to a limited number of concentration limits (*e.g.*, industry and geography) such that portfolios are expected to be relatively concentrated. Moreover, given the research intensive nature of the firm’s investment strategies, the exposure of certain of the funds will be highly concentrated in financially troubled or distressed companies and the aggregate return of the funds may be substantially adversely affected by the unfavorable performance of the overall relative performance of the distressed sector. Concentration in financially troubled or distressed companies may subject the funds to greater volatility than a more diversified portfolio of investments. In addition, because any fund may invest a higher percentage of its assets in a relatively small number of issuers, each fund is more susceptible to any single economic, market, political or regulatory event affecting those issuers than is a more broadly diversified fund.

**Control Investments and Provision of Managerial Assistance.** The funds may make control investments in issuers, obtain rights to participate substantially in and to influence substantially the conduct of the management of issuers or obtain rights to designate directors (and non-executive chairmen) to serve on the boards of directors of issuers. Control investments, or the obtaining of these rights, could give rise to conflicts of interest between the funds and the issuers, and expose the funds to risk of claims by the issuers and their security holders and creditors, risk of liability for environmental damage, product

defect, failure to supervise management, violation of governmental regulations and other types of liability, in which the limited liability characteristic of business operations may be ignored. For example, a conflict of interest may arise when the firm designates one or more directors to the board of an issuer in which a fund managed by the firm invests because the firm's fiduciary duty to act in the best interest of the fund could potentially conflict with a firm-designated director's fiduciary duties with respect to that issuer.

The funds may also be exposed to risk in connection with the disposition of control investments, particularly if a fund (i) obtains material non-public information with respect to any portfolio company on whose board of directors a member of the fund or its affiliates serves or (ii) is subject to trading restrictions pursuant to the internal trading policy of such a portfolio company. Disposition of these investments may be more difficult than if the firm did not have a close relationship with the issuer. The funds may be required to make representations and warranties about the business and financial affairs of the investments typical of those made in connection with the sale of any business, or may be responsible for the contents of disclosure documents under applicable securities law. The funds may also be required to indemnify the purchasers of such investment or underwriters to the extent that any such representations and warranties or disclosure documents turn out to be incorrect, inaccurate or misleading. These arrangements may result in contingent liabilities, which will be borne by the funds and such liabilities may exceed the value of the funds' investments.

**Legal Risks of Funds as Part of Larger Firm.** The firm is part of Avenue Capital, a larger corporate structure with multiple business lines in multiple jurisdictions that are governed by a multitude of legal systems and regulatory regimes, some of which are new and evolving. As a result, the funds, the firm and/or their respective affiliates are subject to a number of unusual risks, including changing laws and regulations, developing interpretations of such laws and regulations and increased scrutiny by regulators. Some of this evolution may result in scrutiny or claims against the funds, the firm and/or their affiliates directly for actions taken or not taken by the funds, the firm and/or their affiliates. Thus, the funds, the firm and/or their respective affiliates face the continuing risk of pending and potential litigation and regulatory action. These risks are often difficult or impossible to predict, avoid or mitigate in advance. The effect on the funds, the firm or any affiliate of any such legal risk, litigation or regulatory action could be substantial and adverse.

**Risk of Minority Positions.** The funds may hold minority positions in issuers. Accordingly, the funds may not be able to exercise control over such issuers. In addition, in certain situations, including where the issuer is in bankruptcy or undergoing a reorganization, minority investors may be subject to the decisions taken by majority investors and the outcome of the funds' investments may depend on such majority controlled decisions, which decisions may not be consistent with the funds' objectives.

**Investments in Pooled Investment Vehicles.** A fund may acquire interests in other pooled investment vehicles, including investing in other pooled investment vehicles managed by the firm or its affiliates, that pursue various investment strategies, and invest in various asset classes. The fund may not participate in the management and control of such pooled investment vehicles or their underlying investments and may not have the opportunity to evaluate the specific investments made by them. In addition, both the fund and such pooled investment vehicles are likely to charge certain operating expenses, which would result in greater expense than if the fund invested directly in the investments of such pooled investment vehicles.

**Non-U.S. Investments.** Non-U.S. investments may involve certain special risks, including the following:

- political, social or economic instability;
- the unpredictability of international trade patterns;

- the possibility of non-U.S. governmental actions such as expropriation, nationalization or confiscatory taxation;
- the imposition or modification of exchange controls; price volatility;
- the imposition of withholding taxes on dividends, interest and gains;
- fluctuations in currency exchange rates;
- different bankruptcy laws and customs; and
- different legal systems and laws relating to creditors' rights.

As compared to U.S. entities, non-U.S. entities generally:

- disclose less financial and other information publicly,
- may be subject to less stringent and less uniform accounting, auditing and financial reporting standards and
- may be subject to less stringent regulatory oversight.

Also, it may be more difficult to obtain and enforce legal judgments against non-U.S. entities than against domestic entities. Non-U.S. markets also have different clearance and settlement procedures which in some markets have at times failed to keep pace with the volume of transactions, thereby creating substantial delays and settlement failures that could adversely affect the funds' performance. Greater tax risks and complexities also may be associated with these investments. The foreign securities in which the funds may invest may be issued by companies or governments located in emerging market countries. Compared to the United States and other developed countries, emerging market countries may have relatively unstable governments, economies based on only a few industries and securities markets that trade a small number of securities. Securities issued by companies or governments located in emerging market countries tend to be especially volatile and may be less liquid than securities traded in developed countries. The funds are not obligated to engage in any currency hedging operations and there can be no assurance as to the success of any hedging operations that the funds may implement.

**Exchange Risk Exposure.** Interests in the funds are generally denominated in U.S. dollars and issued in U.S. dollars. Certain of the assets of the funds may, however, be invested in securities and other investments which are denominated in currencies other than U.S. dollars. Accordingly, the value of such assets may be affected favorably or unfavorably by fluctuations in currency rates. To the extent unhedged, the value of the funds' assets will fluctuate with the U.S. dollar exchange rates as well as the price changes of the funds' investments in the various local markets and currencies. Thus, an increase in the value of the U.S. dollar compared to the other currencies in which the funds make investments will reduce the effect of increases and magnify the U.S. dollar equivalent of the effect of decreases in the prices of the funds' securities in their local markets. Conversely, a decrease in the value of the U.S. dollar will have the opposite effect on the funds' non-U.S. dollar securities. The firm generally intends to hedge the foreign currency exposure of the funds; however, the funds will necessarily be subject to foreign exchange risks. In addition, prospective investors whose assets and liabilities are predominantly in other currencies should take into account the potential risk of loss arising from fluctuations in value between U.S. dollars and such other currencies. The funds may enter into forward contracts to hedge exchange risk exposure.

**Counterparty Risk.** Some of the markets in which the funds may effect transactions are “over-the-counter” or “interdealer” markets. The participants in such markets are typically not subject to credit evaluation and regulatory oversight as are members of “exchange-based” markets. This exposes the funds to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a dispute over the terms of the contract (whether or not bona fide) or because of a credit or liquidity problem, thus causing the relevant fund to suffer a loss. Such “counterparty risk” is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where a fund has concentrated its transactions with a single or small group of counterparties. The funds are generally not restricted from dealing with any particular counterparty or from concentrating any or all of their transactions with one counterparty. Moreover, the funds’ internal counterparty review process, which evaluates the creditworthiness of their counterparties, may prove insufficient. The lack of a complete and “foolproof” evaluation of the financial capabilities of the funds’ counterparties and the absence of a regulated market to facilitate settlement may increase the potential for losses by the funds. Changes in the credit quality of the companies that serve as the funds’ counterparties with respect to derivatives, swaps or other transactions supported by the counterparty’s credit will affect the value of those instruments. Certain entities that have served as counterparties in the markets for these transactions have incurred significant financial hardships including bankruptcy and losses as a result of the credit crisis and making investments that have experienced recent defaults or otherwise suffered extreme credit deterioration. As a result, such hardships have reduced such entities’ capital and called into question their continued ability to perform their obligations under such transactions. By using derivatives, swaps or other transactions, a fund assumes the risk that its counterparties could experience similar financial hardships. In the event of default by, or the insolvency of, a counterparty, such fund may sustain losses or be unable to liquidate a derivative or swap position.

The funds are also subject to the risk of failure of any of the exchanges on which the funds’ positions trade or of their clearinghouses. Because securities owned by a fund that are held by broker-dealers are generally not held in such fund’s name, the bankruptcy of any such broker-dealer could have a greater adverse impact on such fund than if such securities were registered in such fund’s name.

**Systemic Risk.** Credit risk may also arise through a default by one of several large institutions that are dependent on one another to meet their liquidity or operational needs, so that a default by one institution causes a series of defaults by the other institutions. This is sometimes referred to as a “systemic risk” and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which the funds interact on a daily basis.

**Current Economic Conditions in European Countries.** European countries have experienced financial distress to varying degrees. Risks from the debt crisis in Europe could result in a disruption of the financial markets which could have a detrimental impact on global economic conditions. There remains considerable uncertainty as to future developments in the Europe and the impact on global financial markets. A significant deterioration could result in material reductions in the value of sovereign debt and other asset classes, disruptions in capital markets, widening of credit spreads, loss of investor confidence in the financial services industry, a slowdown in global economic activity, and other adverse developments that could negatively impact the performance of the funds.

**Projections.** The funds may make investments relying upon projections developed by the firm, a prospective portfolio company or other third-party source concerning such company’s future performance and cash flow. Projections are inherently subject to uncertainty and factors beyond the control of the firm, the portfolio company or such other sources. The inaccuracy of certain assumptions, the failure to satisfy certain financial requirements and the occurrence of other unforeseen events could impair the ability of a portfolio company to realize projected values.

**Cyber Security Risks.** With the increased use of technologies such as the Internet and the dependence on computer systems to perform necessary business functions, investment vehicles such as funds and their services providers may be prone to operational and information security risks resulting from cyber-attacks. In general, cyber-attacks result from deliberate attacks, but unintentional events may have effects similar to those caused by cyber-attacks. Cyber-attacks include, among other behaviors, stealing or corrupting data maintained online or digitally, denial-of-service attacks on websites, the unauthorized release of confidential information and causing operational disruption. Successful cyber-attacks against, or security breakdowns of, a fund, a general partner, the firm, a fund's custodian and/or other third party service providers may adversely impact a fund or the investors. For instance, cyber-attacks may interfere with the processing of investor transactions, impact a fund's ability to value its assets, cause the release of private investor information or confidential information of a fund, impede trading, cause reputational damage, and subject a fund to regulatory fines, penalties or financial losses, reimbursement or other compensation costs, and/or additional compliance costs. A fund may also incur substantial costs for cyber security risk management in order to prevent any cyber incidents in the future. A fund and the investors could be negatively impacted as a result. While a fund or a fund's service providers have established business continuity plans and systems designed to prevent such cyber-attacks, there are inherent limitations in such plans and systems including the possibility that certain risks have not been identified. Similar types of cyber security risks are also present for issuers of securities or other instruments in which a fund invests, which could result in material adverse consequences for such issuers, and may cause a fund's investment therein to lose value.

**Fraud.** Instances of fraud and other deceptive practices committed by senior management of certain companies in which the funds invest may undermine our due diligence efforts with respect to such companies, and if such fraud is discovered, negatively affect the valuation of the funds' investments. In addition, when discovered, financial fraud may contribute to overall market volatility, which can negatively impact the funds' investment programs.

### **Risks Associated with the Firm's Credit Investments**

**Bank Loans, Participations and Assignments.** The firm's investment program may include investments in significant amounts of bank loans purchased directly through assignment (where the fund is the record holder) or indirectly through participation (participations arise when a fund acquires a beneficial economic interest in a debt obligation but is not the record holder of such instrument; in such instances, there is an agreement between or among the parties to the transaction with respect to the beneficial interest being transferred to the fund).

Assignments and participations are sold strictly without recourse to the selling institutions and the selling institutions will generally make no representations or warranties about the underlying loan, the borrowers, the documentation of the loans or any collateral securing the loans. In addition, the funds will be bound by provisions of the underlying loan agreements, if any, that require the preservation of the confidentiality of information provided by the borrower. Because of certain factors including confidentiality provisions, the unique and customized nature of the loan agreement and the private syndication of the loan, loans are not purchased or sold as easily as are publicly traded securities. Bank loans are subject to various risks including, without limitation:

- the possible invalidation of an investment transaction as a fraudulent conveyance under relevant creditors' rights laws;
- so-called lender-liability claims by the issuer or creditors of the obligations; and
- environmental liabilities that may arise with respect to collateral securing the obligations.

## *Assignments*

The purchaser of an assignment of an interest in a loan typically succeeds to all the rights and obligations of the assigning institution and becomes a lender and record holder under the loan agreement with respect to that loan. As a purchaser of an assignment, a fund generally will have the same voting rights as other lenders under the applicable loan agreement, including the right to vote to waive enforcement of breaches of covenants or to enforce compliance by the borrower with the terms of the loan agreement and the right to set off claims against the borrower and to have recourse to collateral supporting the loan. Assignments, however, are not always available to our funds based on a borrower's restrictions and where available are arranged through private negotiations between assignees and assignors and in certain cases the rights and obligations acquired by the purchaser of an assignment may differ from, and be more limited than, those held by the assigning selling institution.

## *Participations*

In circumstances where owning by assignment is not available or desirable, the fund may purchase loans through participation agreements. Investing through participation agreements is subject to unique risks, including limitations on the ability of the funds to directly enforce their rights with respect to participations. For example:

- In the event of the insolvency of the record holder, a fund, by owning a participation interest, may be treated as a general unsecured creditor of the record holder and may not benefit from any set off between the record holder and the borrower.
- A fund may purchase a participation interest from a selling institution that agrees to be the record holder for the funds but does not itself retain any portion of the applicable loan and, therefore, may have limited interest in monitoring the terms of the loan agreement and the continuing creditworthiness of the borrower.
- When a fund holds a participation interest in a loan it will not have the right to vote under the applicable loan agreement with respect to every matter that arises thereunder and it is expected that the record holder will reserve the right to administer (i.e., vote) the loan sold by it as it sees fit and to amend the documentation evidencing such loan in all respects.
- The record holder may have interests different from those of the funds and may fail to consider the interests of the funds in connection with their votes.

In analyzing each bank loan participation, we compare the relative significance of the risks against the expected benefits of the investment. Successful claims by third parties arising from these and other risks will be borne by the funds.

**Bankruptcy Claims.** The funds may invest in bankruptcy claims, including trade claims, which are amounts owed to creditors of companies in financial difficulty. Bankruptcy claims are illiquid, generally do not pay interest and there can be no guarantee that the debtor will ever be able to satisfy the obligation on the claim. The markets in bankruptcy claims are not generally regulated by U.S. federal or foreign securities laws or regulators. Because bankruptcy claims are frequently unsecured, holders of such claims may have a lower priority in terms of payment than certain other creditors in a bankruptcy proceeding. In addition, under certain circumstances, such investments may be adversely affected by laws relating to, among other things, fraudulent conveyances, voidable preferences, lender liability and the bankruptcy court's discretionary power to disallow, subordinate and disenfranchise certain claims.

The trade claims market, in particular, is highly specialized and consists of purchasing the unsecured debt, or the priority and administrative debt, owed to trade vendors by companies in financial distress. In addition to the risks otherwise associated with low-quality obligations and inherent in investments in entities experiencing financial distress, the risks associated with trade claims include:

- the possibility that the amount of the claim may be disputed by the obligor,
- difficulties in obtaining information regarding the obligor's true financial condition,
- fraud on the part of the assignor of the claim, and
- logistical and mechanical issues that may affect the ability of the fund or its agents to collect on the claim in whole or in part.

**Equitable Subordination.** Common law principles in the jurisdictions in which the funds invest can create lender liability for our funds if a lender (*i.e.*, one or more of our funds):

- intentionally takes an action that results in the undercapitalization of a borrower or issuer to the detriment of other creditors of such borrower or issuer;
- engages in other inequitable conduct to the detriment of such other creditors;
- engages in fraud with respect to, or makes misrepresentations to, such other creditors; or
- uses its influence as a stockholder to dominate or control a borrower or issuer to the detriment of other creditors of such borrower or issuer, a court may elect to subordinate the claim of the offending lender or bondholder to the claims of the disadvantaged creditor or creditors (a remedy called "equitable subordination").

The funds do not intend to engage in conduct that would form the basis for a successful cause of action based upon the equitable subordination doctrine; however, because of the nature of the debt obligations, the funds may be subject to claims from creditors of an obligor that debt obligations of such obligor which are held by the funds should be equitably subordinated. Each jurisdiction will apply this common law doctrine differently and may present additional issues.

**Sovereign and Other Governmental Debt Investments.** The funds may invest their assets in sovereign and other governmental debt instruments, which involve special risks. The governmental authority that controls the repayment of the sovereign and other governmental debt may be unwilling or unable to repay the principal and/or interest when due in accordance with the terms of such securities due to:

- the extent of its cash reserves;
- the availability of sufficient foreign exchange on the date a payment is due;
- the relative size of the debt service burden to the economy as a whole; or
- the government debtor's policy towards the International Monetary Fund and/or other political constraints to which a government debtor may be subject.

In addition, sovereign and other governmental debt instruments may be subject to credit spread risks resulting from exposures to changes in a sovereign and other governmental issuer's probability of default, expected recovery rate and actual default. Some sovereign and other governmental issuers have encountered difficulties in servicing their external debt obligations, which led to defaults on certain obligations and the restructuring of certain indebtedness. If an issuer of sovereign and other governmental



debt defaults on payments of principal and/or interest, the funds may have limited legal recourse against the issuer and/or guarantor. In certain cases, remedies must be pursued in the courts of the defaulting party itself, and the funds' ability to obtain recourse may be limited. All of the funds' investments in sovereign and other governmental debt instruments will be subject to typical market risks.

**DIP Loans.** Debtor-in-possession ("DIP") loans involve a fundamental credit risk based on the borrower's ability to make principal and interest payments and the inherent risks in the bankruptcy process. DIP loans are subject to a court approval process in which parties-in-interest may be heard but there can be no assurance that the funds would be successful in obtaining favorable results. If our calculations as to the outcome or timing of a reorganization are inaccurate, a company that has filed for bankruptcy may not be able to make payments on a DIP loan on time or at all. In addition, DIP loans may be privately negotiated transactions, each of which has individualized terms. These positions may be illiquid and difficult to value. DIP loans may be subject to price volatility due to various factors including, but not limited to, changes in interest rates, market perception of the creditworthiness of the borrower and general market liquidity.

**High Yield Debt Obligations.** High yield debt obligations are generally unsecured and may be subordinated to certain other obligations of the obligor thereof. The lower rating of securities in the high yield sector reflects a greater possibility that adverse changes in the financial condition of an obligor or in general economic conditions or both may impair the ability of the obligor to make payments of principal and interest. In addition, the market for high yield debt securities is not liquid at all times and for all obligors. Particular issues may be held by only a few investors, many of such obligations are not registered under the Securities Act, most are not listed on a securities exchange and market-making activity, if any, may cease at any time during the life of such obligations. Due to potential market volatility, the market value of such high yield debt obligations at any time will vary, and may vary substantially, from the price at which such high yield debt obligations were initially purchased and from the principal amount of such high yield debt obligations. No assurance can be given as to the amount of proceeds of any sale or disposition of any high yield debt obligations (whether upon default or otherwise), or that the proceeds of any such sale or disposition would be sufficient to repay principal of and interest or other amounts due on the notes that may have been issued by a fund using such high yield debt obligations as collateral and pay other amounts payable prior thereto in an amount equal to the outstanding principal and accrued and unpaid interest of such high yield debt obligations.

**Loan Origination.** The funds may seek to originate loans, including, but not limited to, senior, second lien and mezzanine loans and other similar investments. The funds may subsequently offer such investments for sale to third parties; *provided, however*, that, there is no assurance that a fund will complete the sale of such an investment. In determining the target amount to allocate to an originated investment, we may take into consideration the fact that a fund may sell, assign or offer participations in such investment to third parties. Accordingly, if the fund is not successful in offering such participations, this could result in the fund being "overweighted" with respect to a particular borrower.

**Investments in Equity Securities.** The funds may invest their assets in equity securities, including preferred or common stocks. Investments in equity securities of small or medium-sized market capitalization companies will have more limited marketability than the securities of larger companies. In addition, securities of smaller companies may have greater price volatility. All of the funds' investments in stocks will be subject to normal market risks. While diversification among issuers may mitigate these risks, investors must expect fluctuations in value of equity securities held by the funds based on market conditions.

**Options.** The funds may purchase and sell ("write") options on equities on national and international securities exchanges and in the domestic and international over-the-counter market. The seller ("writer")

of a put option which is covered (*e.g.*, the writer has a short position in the underlying security) assumes the risk of an increase in the market price of the underlying security above the sales price (in establishing the short position) of the underlying security, plus the premium received and gives up the opportunity for gain on the underlying security below the exercise price of the option. The seller of an uncovered put option assumes the risk of a decline in the market price of the underlying security below the exercise price of the option. The buyer of a put option assumes the risk of losing its entire investment in the put option. If the buyer of the put holds the underlying security, the loss on the put will be offset in whole or in part by any gain on the underlying security.

The writer of a call option which is covered (*e.g.*, the writer holds the underlying security) assumes the risk of a decline in the market price of the underlying security below the value of the underlying security less the premium received and gives up the opportunity for gain on the underlying security above the exercise price of the option. The seller of an uncovered call option assumes the risk of a theoretically unlimited increase in the market price of the underlying security above the exercise price of the option. The buyer of a call option assumes the risk of losing its entire investment in the call option. If the buyer of the call sells short the underlying security, the loss on the call will be offset, in whole or in part, by any gain on the short sale of the underlying security.

Options may be cash settled, settled by physical delivery or by entering into a closing purchase or closing sale transaction. In entering into a closing purchase transaction, the funds will be subject to the risk of loss to the extent that the premium paid for entering into such closing purchase transaction exceeds the premium received when the option was written.

**Stock Index and Market Options.** The funds may also purchase and sell call and put options on stock indices and exchange traded funds (“ETFs”) listed on national securities exchanges or traded in the over-the-counter market for the purpose of realizing their investment objectives or for the purpose of hedging their portfolios. A stock index or ETF fluctuates with changes in the market values of the stocks included in the index or ETF. The effectiveness of purchasing or writing stock index or ETF options for hedging purposes will depend upon the extent to which price movements in the funds’ portfolios correlate with price movements of the stock indices or ETFs selected. Because the value of an index or ETF option depends upon movements in the level of the index or ETF rather than the price of a particular stock, whether the funds will realize gains or losses from the purchase or writing of options on indices or ETFs depends upon movements in the level of stock prices in the stock market generally or, in the case of certain indices or ETFs, in an industry or market segment, rather than movements in the price of particular stocks. Accordingly, successful use by the funds of options on stock indices or ETFs will be subject to our ability to correctly predict movements in the direction of the stock market generally or of particular industries or market segments. This requires different skills and techniques than predicting changes in the price of individual stocks.

**Event Driven Situation Investing.** Certain funds may focus on securities or indebtedness of companies that are engaging, or which have recently been engaged, in extraordinary transactions and in other special situations (“event driven situations”). Investing in event driven situations entails discovering value by analyzing companies experiencing corporate change. These situations include investing in companies that the firm believes are likely to become the subject of a takeover, merger, exchange offer, rights offering, restructuring, liquidation, spin-off or any other extraordinary event that the firm believes would be likely to increase the value of the companies’ debt or equity securities. Investments in event driven situations typically will entail a higher degree of risk than investments in companies that are not engaging in or have recently engaged in event driven situations. If an evaluation of the anticipated outcome of an event driven situation should prove incorrect, the funds could experience losses. The uncertainties inherent in evaluating such investments may be increased by legal and practical considerations which

limit the access of the firm and its affiliates to reliable and timely information concerning material developments affecting an investment.

The funds may invest and trade in securities and obligations of U.S. or non-U.S. companies which it believes are undervalued in the sense that, although they are not the subject of an announced event driven situation transaction, the companies are, in the view of the firm, potential candidates for such transaction. In such a case, if the anticipated transaction does not in fact occur, the funds may sell the investments at a loss. The funds may invest in the securities of a company engaging in an event driven situation after the event has been announced. Since the price offered for securities of a company involved in an announced transaction may be at a significant premium above the market price prior to the announcement, in the event the proposed transaction is not consummated the value of such securities held by the funds will decline significantly if their market price returns to a level comparable to that which exists prior to the announcement of the transaction.

Furthermore, the difference between the price paid by the funds for securities of a company involved in an announced transaction and the anticipated value to be received for such securities upon consummation of the proposed transaction will often be very small. If the proposed transaction appears likely not to be consummated or, in fact, is not consummated or is delayed, the market price of the securities will usually decline sharply, perhaps by more than the funds' anticipated profit.

Investing in securities in anticipation of a merger is extremely competitive. The funds compete with firms, including many of the larger investment banking firms, which have substantially greater financial resources, larger research staffs and more securities traders than are available to the funds.

We will attempt to assess all of the foregoing risk factors, and others, in determining the extent of the position the funds will take in the relevant securities and the price the funds are willing to pay for such securities. However, such risks cannot be eliminated.

**Repurchase Agreements and Reverse Repurchase Agreements.** A fund may invest in repurchase agreements and reverse repurchase agreements. In its purchase of repurchase agreements, such fund does not bear the risk of a decline in the value of the underlying security unless the seller defaults under its repurchase obligation. In the event of the bankruptcy or other default of a seller of a repurchase agreement, the fund could experience both delays in liquidating the underlying securities and losses, including possible decline in the value of the underlying security during the period while the fund seeks to enforce its rights thereto, possible lack of access to income on the underlying security during this period, and expenses of enforcing its rights.

**Credit Derivative Transactions.** As part of its investment strategy, a fund may enter into credit derivative transactions. Credit derivatives are transactions between two parties which are designed to isolate and transfer the credit risk associated with a third-party (the "reference entity"). Credit derivative transactions in their most common form consist of credit default swap transactions under which one party (the "credit protection buyer") agrees to make one or more fixed payments in exchange for the other party's (the "credit protection seller") obligation to assume the risk of loss if an agreed-upon "credit event" occurs with respect to the reference entity. Credit events are specified in the contract and are intended to identify the occurrence of a significant deterioration in the creditworthiness of the reference entity (mainly a default on a material portion of its outstanding obligations, a bankruptcy or a restructuring of its debt). Upon the occurrence of a credit event, credit default swaps may be cash settled (either directly or by way of an auction) or physically settled. If the transaction is cash settled, the amount payable by the credit protection seller following a credit event will usually be determined by reference to the difference between the nominal value of a specified obligation of the reference entity and its market value after the occurrence of the credit event (which sometimes may be established in an industry-wide auction process). If the transaction is physically settled, the credit protection buyer will

deliver an obligation of the reference entity that is either specified in the contract or the general characteristics are described therein to the credit protection seller in return for the payment of its nominal value.

Credit derivatives may be used to create an exposure to the underlying asset or reference entity, to reduce existing exposure or to create a profit through trading differences in their buying and selling prices. The funds may enter into credit derivatives transactions as protection buyers or sellers.

There are a number of uncertainties in the tax laws relating to credit default swaps. There can be no assurance that the characterization adopted by the funds with respect to a particular credit default swap will be respected by the Internal Revenue Service or a court, and any re-characterization by the Internal Revenue Service, if successful, could adversely affect the investors' investments in the funds.

Credit derivative transactions are an established feature of the financial markets and both the number of participants and range of products available have significantly increased over the years. Credit derivative transactions dependent upon credit events are priced incorporating many variables including the pricing and volatility of the referenced instrument of the derivative, potential loss upon default of the reference instrument or issuer, and the shape of the curve of the applicable risk-free rate, among other factors. As such, there are many factors upon which market participants may have divergent views. Additionally, credit derivatives may require the posting of collateral. A bankruptcy of the collateral holder may result in losses to the extent posted collateral exceeds the obligations of the pledging party under the credit derivative transaction.

Transactions in certain derivatives are subject to trading and clearing on a U.S. national exchange and clearinghouse and to regulatory oversight, while other derivatives are subject to risks of trading in the "over-the-counter" ("OTC") markets or on non-U.S. exchanges. Certain credit index derivatives are currently required to be traded on a Swap Execution Facility and cleared through a registered clearinghouse. For swaps that are cleared through a clearinghouse, the funds will face the clearinghouse as legal counterparty and will be subject to clearinghouse performance and credit risk. Clearinghouse collateral requirements may differ from and be greater than the collateral terms negotiated with derivatives counterparties in the OTC market, and U.S. regulators have discretion to set collateral requirements for trades that are not cleared through a clearinghouse. OTC derivative dealers will be required to post margin to the clearinghouse through which they clear their customers' trades instead of using such margin in their operations, as they historically were allowed to do. This will further increase the dealers' costs, which costs are expected to be passed through to other market participants in the form of higher fees and less favorable dealer marks. In addition, the funds' assets are also subject to the risk of the failure of any of the exchanges on which its positions trade or of its clearinghouses or counterparties.

**Other Derivatives.** The funds may take advantage of opportunities in the area of swaps, options on various underlying instruments and certain other customized derivative instruments. The funds may enter into swap transactions, including credit default, total return, index and interest rate swap agreements, as well as options thereon, and may purchase or sell interest rate caps, floors and collars. In addition, the funds may take advantage of opportunities with respect to certain other derivative instruments which are not presently contemplated for use by the funds or which are currently not available. Derivative instruments contain much greater leverage than do non-margined purchases of the underlying instrument in as much as only a very small portion of the value of the underlying instrument is required to be posted as collateral in order to effect such investments. If the counterparty to such a swap defaults, the fund would lose any collateral deposits made with the counterparty in addition to the net amount of payments that it is contractually entitled to receive under the swap. Many derivatives instruments are traded on a principal to principal basis, in which performance with respect to such instruments is the responsibility of only the parties to the contract, and not of any exchange or clearinghouse. As a result, many of the

protections afforded to participants on organized exchanges and in a regulated environment are not available in connection with these transactions and the fund will be subject to counterparty risk relating to the inability or refusal of a counterparty to perform such derivatives contracts. If the counterparty's creditworthiness declines, the value of a swap agreement would be likely to decline, potentially resulting in losses of the fund. Other risks may include market risk, liquidity risk, legal risk and operations risk. Swaps generally do not involve delivery of securities, other underlying assets or principal. Accordingly, the risk of loss with respect to swaps generally is limited to the net amount of payments that the fund is contractually obligated to make, or in the case of the other party to a swap defaulting, the net amount of payments that the fund is contractually entitled to receive. If the firm is incorrect in its forecast of market values, interest rates or currency exchange rates, the investment performance of the funds would be less favorable than it would have been if these investment techniques were not used.

Special risks may apply to instruments which are invested in by the funds in the future which cannot be determined at this time or until such instruments are developed or invested in by the funds. For example, certain types of derivative instruments may be highly illiquid and it is possible that the funds will not be able to terminate such derivative instruments prior to their expiration date or that the penalties associated with such a termination might impact the funds' performance in a material adverse manner. If the funds seek to participate through the use of such derivative instruments, the funds will not acquire any voting interests or other shareholder rights that would be acquired with a direct investment in the underlying securities or financial instruments. Accordingly, the funds will not participate in matters submitted to a vote of the shareholders. In addition, the funds may not receive all of the information and reports to shareholders that the funds would receive with a direct investment. Further, the funds will pay the counterparty to any such derivative instrument structuring fees and ongoing transaction fees, which will reduce the investment performance of the funds. Finally, certain aspects of the appropriate U.S. federal income tax treatment of such derivative instruments are uncertain and, if a fund's U.S. federal income tax treatment of such instruments proves to be inappropriate, an investor's after tax return from its investment in a fund may be adversely affected.

Transactions in certain derivatives are subject to clearance on a U.S. national exchange and to regulatory oversight, while other derivatives are subject to risks of trading in the OTC market or on non-U.S. exchanges. As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and the European Union Regulation No 648/2012 on OTC derivatives, central counterparties and trade repositories (also known as the European Market Infrastructure Regulation, or "EMIR"), swaps are subject to increased regulation. Such regulation could:

- significantly increase the cost of derivative contracts (including through requirements to post collateral which could adversely affect a client's available liquidity);
- materially alter the terms of derivative contracts;
- reduce the availability or desirability of derivatives;
- reduce the ability to monetize or restructure existing derivative contracts; and
- increase a client's exposure to less creditworthy counterparties.

In particular, the Dodd-Frank Act amendments to the Advisers Act require a large proportion of transactions in the derivatives markets to be conducted on a swap execution facility. The impact of the swap execution facilities on transaction liquidity and pricing cannot be determined at this time. Currently, the clearing mandate applies to certain interest rate and credit index swaps. Swaps that are not cleared through registered clearinghouses are potentially subject to regulations including increased mandatory margin requirements without the benefit of protections afforded to participants in cleared swaps (for

example, centralized counterparty, guaranteed funds and customer asset segregation). Price movements of futures and options contracts and payments pursuant to swap agreements are influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and national and international political and economic events and policies. The value of futures, options and swap agreements also depends upon the price of the commodities underlying them. Therefore, many of the risks applicable to trading the underlying asset are also applicable to derivatives trading.

In addition, there is no assurance that the funds themselves will not be determined to be a regulated market participant or otherwise become subject to new entity-level regulation as a result of the Dodd-Frank Act. Such additional regulation could lead to significant new costs which could materially adversely affect the performance of the funds.

EMIR requires all counterparties to derivatives to report all derivative contracts (OTC and exchange traded) to a trade repository. The reporting obligation applies separately to each applicable counterparty but may be delegated. Reporting to a trade repository requires a significant amount of preparation and resources, such as selecting and registering with a trade repository and putting in place internal systems to enable reporting of derivative contracts. It is difficult to predict the precise impact of EMIR on the funds. The firm will monitor the position and react appropriately. However, prospective investors should be aware that the regulatory changes arising from EMIR may in due course adversely affect the funds' ability to adhere to its investment strategy and achieve its investment objective.

**Risks of Clearing Houses, Counterparties or Exchange Insolvency.** The liquidity of a secondary market in derivatives is subject to the risk of trading halts, suspensions, exchange or clearing house equipment failures, government intervention, insolvency of a brokerage firm, clearing house or exchange or other disruptions of normal trading activity, including prime brokers refusing to clear or settle any trade.

**Synthetic Obligations.** Synthetic obligations, *i.e.*, swap transactions, structured investments or other investments purchased from, or entered into by a fund, with respect to a reference debt security or other obligation, present risks in addition to those resulting from direct purchases of the reference obligations underlying such synthetic obligations. With respect to each synthetic obligation, the relevant fund will usually have a contractual relationship only with the counterparty of such synthetic obligation, and not the reference obligor on the reference obligation. The fund generally will have no right directly to enforce compliance by the reference obligor with the terms of the reference obligation nor any rights of set-off against the reference obligor (and may be subject to setoff rights exercised by the reference obligor against the counterparty or another person or entity), nor have any voting or other consensual rights of ownership with respect to the reference obligation. The fund will not directly benefit from any collateral supporting the reference obligation and will not have the benefit of the remedies that would normally be available to a holder of such reference obligation. In addition, in the event of the insolvency of the counterparty, the fund will be treated as a general creditor of such counterparty, and will not have any claim with respect to the reference obligation. Consequently, the fund will be subject to the credit risk of the counterparty as well as that of the reference obligor.

**Structured Products.** Structured products, including collateralized debt obligations, or CDOs, collateralized bond obligations, or CBOs, collateralized loan obligations, or CLOs, structured notes, credit-linked notes and other types of structured products, representing a non-recourse or limited-recourse obligation issued by a special purpose vehicle, may present risks that are greater than those presented by other types of collateralized loan obligations. Holders of structured products bear risks of the underlying investments, index or reference obligation and are subject to counterparty risk. The holder of a structured product may have the right to receive payments to which it is entitled only from the issuer of the

structured product, and generally does not have direct rights against the issuer of, or the entity that sold, assets underlying the structured product. Certain structured products may be thinly traded or have a limited trading market and may have the effect of increasing a fund's illiquidity to the extent that the fund, at a particular point in time, may be unable to find qualified buyers for, and may have difficulty valuing, these securities. CBOs, CLOs and other CDOs are typically privately offered and sold, and thus, are not registered under the securities laws. Structured products may also be subject to prepayment risk, credit risk, structural risk, legal risk and interest rate risk (which may be exacerbated if the interest rate payable on a structured finance obligation changes based on multiples of changes in interest rates or inversely to changes in interest rates). In addition, the performance of a structured product will be affected by a variety of factors, including its priority in the capital structure of the obligor thereof, the availability of any credit enhancement, the level and timing of payments and recoveries on and the characteristics of the underlying loans or other assets that are being securitized, remoteness of those assets from the originator or transferor, the adequacy of and ability to realize upon any related collateral and the capability of the servicer of the securitized assets.

**Forward Trading.** The funds may invest in forward contracts and options thereon, which, unlike futures contracts, are not traded on exchanges and are not standardized; rather banks and dealers act as principals in these markets, negotiating each transaction on an individual basis. Forward contracts may be entered into, for among other reasons, to hedge exchange risk exposure. Forward and "cash" trading is substantially unregulated; there is no limitation on daily price movements and speculative position limits are not applicable. The principals who deal in the forward markets are not required to continue to make markets in the currencies or commodities they trade and these markets can experience periods of illiquidity, sometimes of significant duration. There have been periods during which certain participants in these markets have refused to quote prices for certain currencies or commodities or have quoted prices with an unusually wide spread between the price at which they are prepared to buy and that at which they were prepared to sell. Disruptions can occur in any market traded by the funds due to unusually high trading volume, political intervention or other factors. The imposition of controls by government authorities might also limit such forward (and futures) trading to less than that which we would otherwise recommend, to the possible detriment of the funds. Market illiquidity or disruption could result in major losses to the funds.

**Futures Transactions.** Futures transactions involve the execution and clearing of trades on an exchange, the laws and regulations of which will vary depending on the country in which the transaction occurs. The funds may not be afforded certain protections, including the right to use domestic alternative-dispute-resolution procedures depending on the exchange on which it participates in futures transactions. Also, funds received to margin foreign futures transactions may not be provided the same protections in all jurisdictions. In addition, the price of any futures or option contract and, therefore, the potential profit and loss resulting therefrom, may be affected by any fluctuation in the exchange rate between the time the order is placed and the futures contract is liquidated or the option contract is liquidated or exercised.

**Liquidity of Futures Contracts.** The funds may use futures as part of their investment program. Avenue will determine and pursue all steps that are necessary and advisable to ensure compliance with the U.S. Commodity Exchange Act and the rules and regulations promulgated thereunder. Futures positions may be illiquid because certain commodity exchanges limit fluctuations in certain futures contract prices during a single day by regulations referred to as "daily price fluctuation limits" or "daily limits." Under such daily limits, during a single trading day no trades may be executed at prices beyond the daily limits. Once the price of a particular futures contract has increased or decreased by an amount equal to the daily limit, positions in that contract can neither be entered into nor liquidated unless traders are willing to effect trades at or within the limit. Futures prices have occasionally moved beyond the daily limits for several consecutive days with little or no trading. Over-the-counter instruments generally are not as liquid as instruments traded on recognized exchanges. These constraints could prevent the funds from

promptly liquidating unfavorable positions and subject the funds to substantial losses. In addition, the CFTC and various exchanges impose speculative position limits on the number of positions that may be indirectly held or controlled in particular commodities.

**Hedging Transactions.** The distressed market in which the funds may invest is subject to fluctuations and the market value of any particular investment may be subject to substantial variation. The entire market or, particular securities traded on a market may decline even if earnings or other factors improve since the prices of debt securities and equity securities are subject to numerous economic, political, procedural and other factors that have little or no correlation to the performance of a particular company. The funds may utilize a variety of financial instruments, such as derivatives, exchange-traded funds, options, shorting securities, interest rate swaps, caps and floors, futures and forward contracts, both for investment purposes and for risk management purposes. When used for hedging purposes, an imperfect or variable degree of correlation between price movements of the derivative instrument and the underlying investment sought to be hedged may prevent the funds from achieving the intended hedging effect or expose the funds to risk of loss. While the funds may enter into hedging transactions to seek to reduce risk, such transactions may result in a poorer overall performance for the funds than if they had not engaged in any such hedging transaction. We may determine not to hedge a position and may not identify appropriate risks to hedge. Moreover, it should be noted that the funds' portfolios will always be exposed to certain risks that cannot be hedged.

In connection with a hedging transaction, the funds' may be required to allocate funds or provide a credit line to be used as collateral for the margin capital of the hedge. Such a requirement would tie up a portion of the funds' capital that could otherwise have been available for investment. This could cause a fund to be less invested in its core investment strategy than it would have been absent such hedging transaction, and could possibly result in an adverse effect on the overall returns of the funds.

Furthermore, the funds' ability to enter into hedging transactions may be limited by their compliance with CFTC Rule 4.13(a)(3)'s "de minimis" requirements with respect to the funds' commodity interest positions.

**General Risks of Real Estate Ownership.** The funds may acquire, indirectly, debt interests in real estate. The real estate investments of the funds will be subject to the risks generally incident to the ownership and the development and/or redevelopment of real property, including:

- the risk that construction may not be completed within budget or on schedule because of cost overruns, work stoppages, shortages of building materials, the inability of contractors to perform their obligations under construction contracts, defects in plans and specifications or in construction or other factors;
- uncertainty of cash flow to meet fixed and other obligations;
- adverse changes in local market conditions, population trends, neighborhood values, community conditions, general economic conditions, local employment conditions, interest rates, and real estate tax rates;
- changes in fiscal policies;
- competition from other properties; and
- uninsured losses and other risks that are beyond the control of the funds such as the threat of terrorism and their consequences.



There can be no assurance of profitable operations because the cost of owning the funds' investments may exceed the income produced, particularly since certain expenses related to real estate and its development and ownership, such as property taxes, utility costs, maintenance costs and insurance, tend to increase over time and are largely beyond the control of the owner.

**Risks Arising from Investments in Real Estate Acquired from Distressed or Bankrupt**

**Organizations.** Certain real estate investment opportunities may originate from owners which are insolvent or in serious financial difficulty. As a result, the recourse to the sellers and/or the standards by which such properties are being serviced or operated may be adversely affected.

**Other Investments.** As we consider appropriate, and to the extent consistent with the funds' investment strategies, we may invest a portion of the funds' assets in one or more money market funds, collective investment trusts, mutual funds and/or exchange-traded funds. When any such investments are made, a fund investor will effectively be paying, in addition to the compensation payable to Avenue, such fund investor's proportionate share of any management fees, or other compensation, charged by the manager of such money market fund, collective investment trust, mutual fund or exchange traded fund, as well as a *pro rata* portion of the expenses incurred by such entity.

**Use of Leverage.** All funds have the ability to use security-level leverage in respect of their investments, and certain of our funds invest in asset classes (derivatives and options) that include implicit leverage. As a general matter, most of our funds do not use fund-level leverage as part of their investment strategy(ies), although each fund has the authority to do so. For a detailed description of the specific leverage restrictions with respect to a fund and/or the manner in which leverage may be employed by a fund, please refer to that fund's offering documents.

Certain of the funds may obtain leverage using any form or combination of financial leverage instruments, including reverse repurchase agreements, credit facilities such as bank loans or commercial paper, and the issuance of preferred shares or notes. These funds may use fund-level leverage opportunistically and may choose to increase or decrease leverage, or use different types or combinations of leveraging instruments, at any time based on the firm's assessment of market conditions and the investment environment. There can be no assurance that a fund will use any form of leverage as part of its investment program, or that it will do so successfully.

Leverage creates risks, including the likelihood of greater volatility of net asset value and the risk that fluctuations in the costs to borrow may affect the return to holders of interests in the funds. To the extent the income derived from investments purchased with proceeds received from leverage exceeds the cost of leverage, the funds' distributions will be greater than if leverage had not been used. Conversely, if the income from the investments purchased with such proceeds is not sufficient to cover the cost of the financial leverage, the amount available for distribution to investors will be less than if leverage had not been used. In the latter case, the funds may nevertheless maintain leveraged position if such action is deemed to be appropriate based on market conditions.

The costs of a financial leverage program will be borne by the relevant funds and consequently will result in a reduction of the net asset value of the funds. Leverage increases the size of a fund's portfolio. Because certain funds may pay fees based on the size of the funds' portfolios, without deduction for potential exposure, whether created by leverage or otherwise, during periods in which a fund is using leverage, the fees paid by the fund for investment advisory services will be higher than if the fund did not use leverage. This may create a conflict of interest between the firm, on the one hand, and holders of interests in the funds, on the other hand.

Any lender in connection with a credit facility may impose specific restrictions as condition to borrowing. The credit facility fees may include, among other things, up front structuring fees and on-going

commitment fees (including fees on amounts undrawn on the facility) in addition to the traditional interest expense on amounts borrowed. The credit facility may involve a lien on the relevant fund's assets. Similarly, to the extent a fund issues preferred shares or notes for which it seeks a credit rating from one or more rating agencies, the fund may be subject to fees, covenants and investment restrictions required by the rating agency as a result. Such covenants and restrictions imposed by a rating agency or lender may include asset coverage or portfolio composition requirements that are more stringent than those imposed by applicable law.

For administrative convenience, we expect that funds will, from time to time, borrow capital in lieu of drawing down capital commitments and apply subsequent drawdowns to repay such borrowings and interest thereon ("administrative borrowings"). The use of administrative borrowings may (i) increase a fund's costs and expenses by incurring interest that would not otherwise be required of the fund and (ii) decrease the preferred return that would be payable to the fund's investors if their capital commitments are drawn down for a reduced time period.

The funds also expect to enter into other transactions that may give rise to a form of leverage including, among others, swaps, futures and forward contracts, options and other derivative transactions.

**Short Selling.** The funds' investment program may include short selling. Short selling involves selling securities which may or may not be owned by the seller and borrowing the same securities for delivery to the purchaser, with an obligation to return the borrowed securities to the lender at a later date. Short selling allows the seller to profit from declines in market prices to the extent such decline exceeds the transaction costs and the costs of borrowing the securities. The extent to which a fund engages in short sales will depend upon its investment strategy and perception of market direction. A short sale creates the risk of a theoretically unlimited loss, in that the price of the underlying security could theoretically increase without limit, thus increasing the cost to the funds of buying those securities to cover the short position. There can be no assurance that the securities necessary to cover a short position will be available for purchase at the time a fund desires to close out such short position. Purchasing securities to close out the short position can itself cause the price of the securities to rise further, thereby exacerbating the loss.

Securities regulators of many jurisdictions have implemented certain restrictions and disclosure requirements with respect to short selling of securities and may impose additional restrictions in the future. The restrictions on, and disclosures of, the funds' short sales could have an adverse impact on the markets and investments in which the funds transact.

**Securities Lending.** The risks in lending portfolio securities, as with other extensions of credit, consist of the failure of another party, in this case the approved intermediary, to comply with the terms of agreement entered into between the lender of the securities (*i.e.*, a fund) and the approved intermediary (*i.e.*, the prime broker). Such failure to comply can result in the possible loss of rights in the collateral put up by the borrower of the securities, the inability of the approved intermediary to return the securities deposited by the fund and the possible loss of any corporate benefits (including, without limitation, certain voting rights) accruing to the fund from the securities deposited with the approved intermediary.

## **Item 9. Disciplinary Information**

This Item is not applicable to us.

## **Item 10. Other Financial Industry Activities and Affiliations**

### **Material Financial Industry Affiliations of the Firm**

The firm currently has no direct relationships with any funds.

Through affiliated entities, the firm currently has indirect relationships with the following additional funds:

- Avenue Special Situations Fund IV, L.P.
- Avenue Special Situations Fund IV (Parallel), L.P.
- Avenue Special Situations Fund V, L.P.
- Avenue Special Situations Fund VI (A), L.P.
- Avenue Special Situations Fund VI (B-Feeder), L.P.
- Avenue Special Situations Fund VI (B), L.P.
- Avenue Special Situations Fund VI (C-Feeder), L.P.
- Avenue Special Situations Fund VI (C), L.P.
- Avenue Special Situations Fund VI (Master), L.P.
- Avenue Investments, L.P.
- Avenue International, Ltd.
- Avenue International Master, L.P.
- Avenue Real Estate Fund, L.P.
- Avenue Real Estate Fund (Parallel), L.P.
- Avenue-CDP Global Opportunities Fund, L.P.
- Avenue Special Opportunities Fund I, L.P.
- Avenue Special Opportunities Co-Investment Fund I, L.P.
- Avenue Strategic Opportunities Fund, L.P.
- Avenue COPPERS Opportunities Fund, L.P.
- Avenue Credit Opportunities Fund, L.P.
- Avenue Energy Opportunities Fund, L.P.
- Avenue Aviation Opportunities Fund, L.P.

- Avenue Gabriel Fund, L.P.
- Pecos Partners, L.P.
- Avenue Employee Participation Plan, LLC
- Avenue Real Estate Employee Participation Plan, LLC
- Avenue PPF Opportunities Fund, L.P.
- Avenue US/Europe Distressed Segregated Portfolio, a segregated portfolio of Avenue Entrust Customized Portfolio SPC
- MAGS Capital II, LLC
- Avenue-ASRS Europe Opportunities Fund, L.P.
- Avenue Asia Special Situations Fund IV, L.P.
- Avenue Asia Employee Participation Plan, LLC
- Avenue Europe Special Situations Fund II (Euro), L.P.
- Avenue Europe Special Situations Fund II (Euro-Feeder), L.P.
- Avenue Europe Special Situations Fund II (U.S.), L.P.
- Avenue Europe Special Situations Fund III (Euro), L.P.
- Avenue Europe Special Situations Fund III (U.S.), L.P.
- Avenue Europe Special Situations Fund, L.P.
- Avenue Europe Special Situations Fund (Parallel), L.P.
- Avenue Europe Select Opportunities Fund, L.P.
- Avenue-SLP European Opportunities Fund, L.P.
- Avenue Europe Opportunities Fund, L.P.
- Avenue Europe Opportunities Fund, Ltd.
- Avenue Europe Opportunities Intermediate Fund, L.P.
- Avenue Europe Opportunities Master Fund, L.P.
- Avenue Europe Private Opportunities Fund, L.P.
- Avenue Europe Private Opportunities Co-Investment Fund, L.P.
- Avenue Europe Capital Solutions Fund, L.P.

- Avenue Europe Capital Solutions Feeder, L.P.
- Avenue Europe Employee Participation Plan, LLC
- GL Europe Iberian SGR Cayman, Ltd.
- Avenue Europe Iberian Opportunity Fund, L.P.
- Avenue SGR Fund, L.P.

An affiliate of the firm, Avenue Capital Management II, L.P., serves as adviser to Avenue funds that are registered investment companies.

The firm has relationships with the following entities that act as investment advisers:

- Avenue Capital Management II, L.P. (registered as an investment adviser with the SEC since 2000)
- Avenue Asia Capital Management, L.P. (registered as an investment adviser with the SEC since 2001 and registered with the Securities and Exchange Board of India as a Foreign Institutional Investor since 2008)
- Avenue Europe International Management, L.P. (registered as an investment adviser with the SEC since 2004)

The firm has relationships with the following entities (general partners or managing members (in accordance with the 2005 SEC Letter) of funds that are advised by our investment adviser affiliates and certain entities used to carry on the these affiliates' businesses) of certain of its investment adviser affiliates:

- Avenue Capital Partners IV, LLC
- Avenue Capital Partners V, LLC
- Avenue Capital Partners VI, LLC
- Avenue International Master GenPar, LLC
- Avenue Partners, LLC
- Avenue Real Estate GenPar, LLC
- Avenue Global Opportunities Fund GenPar, LLC
- Avenue SO Capital Partners I, LLC
- Avenue SO Capital Partners II, LLC
- Avenue Strategic Opportunities Fund GenPar, LLC
- Avenue COPPERS Opportunities Fund GenPar, LLC
- Avenue Credit Opportunities Partners, LLC

- Avenue Energy Opportunities Partners, LLC
- Avenue Aviation Opportunities Partners, LLC
- Avenue PPF Opportunities Fund GenPar, LLC
- Avenue Gabriel GenPar, LLC
- Pecos Strategic Partners, LLC
- Avenue Credit Opportunities Partners, LLC
- Avenue-ASRS Europe Opportunities Fund GenPar, LLC
- Avenue Asia Capital Partners IV, Ltd.
- Avenue Europe Capital Partners II, LLC
- Avenue Europe Capital Partners III, LLC
- Avenue Europe Capital Partners, LLC
- Avenue Europe Opportunities Fund GenPar, LLC
- Avenue Europe Select Opportunities Partners, LLC
- Avenue-SLP European Opportunities Fund GenPar, LLC
- Avenue EPO Partners, LLC
- Avenue Europe Capital Solutions Partners, LLC
- Avenue SGR GenPar, L.P.
- Avenue Europe Iberian Opportunity GenPar, L.P.
- Avenue Luxembourg S.A.R.L.

In addition, affiliates of the firm have relationships with the following entities (sub-advisers to funds that are advised by such affiliates) that are their “relying advisers” (in accordance with the letter dated January 12, 2012 from the SEC’s Office of Investment Adviser Regulation, Division of Investment Management to the American Bar Association, Business Law Section):

- Avenue Asia Services, LLC
- Avenue Asia Advisors Private Limited
- Avenue Asia Singapore Pte Ltd.
- Bo Yuan Jun He Consulting (Beijing) Co., Ltd.
- IH Services HK Limited

- GL Advisors Hong Kong Limited (holding a Type 9 (asset management) license with the Securities and Futures Commission of Hong Kong since August 2015)
- GL India Mauritius III Ltd. (registered with the Securities and Exchange Board of India as a Foreign Institutional Investor since 2008)
- GL Advisors Australia Pty. Ltd.
- MSM Luxembourg Sarl
- MSM Netherlands BV
- Avenue Europe Management, LLP (authorized by the U.K. Financial Conduct Authority, formerly known as the U.K. Financial Services Authority, since 2004)
- Avenue Germany Management GMBH
- Avenue Iberia Asesores, S.L.
- Avenue Italia Advisors S.r.l.

In October 2006, Morgan Stanley became an indirect minority owner of Avenue. From time to time, certain funds may utilize Morgan Stanley for prime brokerage, consulting and other services.

A-III Manager LLC, which is owned fifty percent by Avenue Real Estate Management LLC (which in turn is owned by Marc Lasry) and fifty percent by a third party, serves as the external manager for ACRE Realty Investors Inc., a real estate investment and operating company. Additional information regarding ACRE Realty Investors Inc. can be found on ACRE's website (<http://www.acrerealtyinvestors.com>) and/or the SEC's EDGAR search engine (<http://www.sec.gov/edgar/searchedgar/companysearch.html>).

Avenue is also affiliated with Amroc Investments, LLC. Marc Lasry and Sonia Gardner, the Senior Principals of Avenue, own Amroc. As of January 1, 2008, all of Amroc's employees became employees of Avenue entities and there are no commissions or other fees paid to Amroc for sourcing investments. We do not believe that the firm's relationship with Amroc is material to our ongoing business activities.

A number of entities with which the firm is affiliated serve as the general partners of funds whose investment programs are managed by the firm and/or by affiliates of the firm.

## **Other Activities**

Except as otherwise set forth in a fund's offering documents, no Avenue person is obligated to devote any specific amount of time to the affairs of the funds or managed accounts. Avenue persons spend substantial time on other business activities, including those related to various existing and future pooled investment vehicles and other client accounts sponsored, formed, offered and managed by Avenue and its affiliates. See Item 8 under the heading "Methods of Analysis, Investment Strategies and Risk of Loss – Risks Associated with the Firm's Investment Strategies - Other Activities."

Furthermore, the Senior Principals of Avenue, and other officers and employees of Avenue and its affiliates, may, from time to time, serve on the boards of directors, credit committees, or other committees, of one or more entities in which one or more of the Avenue funds or managed accounts has invested. In addition, certain Avenue persons, or entities affiliated with such persons, may, from time to time, provide certain services to the firm, the funds, one or more of the firm's other affiliates, and/or one

or more of the investments or companies in which the funds invest. As a result, there may be a number of conflicts of interest which may arise, which could adversely affect the funds and/or managed accounts of the firm. Please see the disclosure provided elsewhere in this brochure under Item 8 as well as in the offering documents of the applicable fund.

Avenue persons engage in a broad range of investment management activities, including sponsoring and managing other funds and/or affiliated special purpose acquisition companies and other activities. Certain Avenue persons also expect to sponsor and operate future pooled investment vehicles and other client accounts that pursue similar investment objectives or other lines of investment activity. Although the relationships and activities of Avenue persons should enable these entities to offer attractive opportunities and services to the funds and investors, such relationships and activities, in the ordinary course of business, may also give rise to circumstances in which the interests of these entities and other affiliates of the Avenue persons conflict with the interests of the funds and investors, including, by way of example but not limitation, competition with other investment vehicles (proprietary or third-party managed) in which investors may also have an interest, purchasing and investments in entities in which investors may have an interest, or taking or advocating positions in certain transactions that may be considered adverse to the interests of investors.

The Avenue persons, the funds, the general partners of such funds (if applicable) or their respective members, officers, directors, employees, principals or affiliates may come into possession of material, non-public information. The possession of such information may limit the ability of the funds to buy or sell a security or otherwise to participate in an investment opportunity.

## **Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### **Code of Ethics; Personal Trading**

We have adopted a written code of ethics that applies to the firm, our employees and certain related persons. Our code of ethics is administered by our Chief Compliance Officer or his designees. Employees are given training with respect to our code of ethics when they are hired and annually thereafter. Each client may obtain a copy of our code of ethics by submitting a written request to Eric Ross at 399 Park Avenue, 6th Floor, New York, New York 10022 or by contacting Mr. Ross at (212) 878-3500.

The following general principles and standards of conduct are established by our code of ethics:

- We must operate at the highest level of ethical standards in keeping with our fiduciary duties to clients, and in compliance with all applicable laws.
- We have a duty to place the interests of clients first and to address and/or mitigate conflicts of interest.
- Information about our operations and investment strategies, as well as information about investors in our funds or our managed account clients (other than, possibly, their name), unless otherwise consented to by the investor, is strictly confidential and will not be disclosed to anyone outside the firm and its consultants and agents, unless required by law or a government agency and upon prior notice to the Chief Compliance Officer.



- Our employees may not use any confidential information or otherwise take inappropriate advantage of their position for the purpose of furthering any private interest or as a means of making any personal gain.
- Our employees and their immediate families may not accept any benefit from a client, an investor in one or more of our funds or person who does business with us, except for normal business courtesies and non-cash gifts of nominal value, except as otherwise provided for by our code of ethics.
- Insider trading is prohibited and may expose an employee to stringent penalties.

Our code of ethics deals with a range of topics including, without limitation, the following:

- Categories of persons related to the firm who are covered by the code of ethics.
- Opening of personal securities accounts by covered persons.
- Pre-approval requirement for most personal securities transactions.
- Submission to the firm of information concerning personal securities holdings and transactions.
- Restrictions on trading in securities of particular issuers.
- Gifts, entertainment and investee company promotions (*i.e.*, any discounted or complimentary goods or services provided by an investee company to a firm employee, such as hotel rooms).
- Charitable contributions.
- Political contributions and payments.
- Reporting of violations and our whistle-blower policy.
- How the code of ethics is administered.
- How exceptions to the code of ethics may be granted by our Chief Compliance Officer.

Each covered person is required to acknowledge that he or she has received and reviewed, and understands the Code of Ethics.

### **Participation or Interest in Client Transactions**

We do not presently intend to engage in principal transactions, but we do have the right to engage in such transactions and may do so in the future. During the most recent fiscal year, the firm did not engage in principal transactions. Further, any fund that is deemed to hold “plan assets,” as defined under ERISA, is prohibited from entering into such transactions.

A principal transaction occurs when an investment adviser, acting for its own account (or the account of an affiliate) buys a security from, or sells a security to, a client’s account, whereas an agency cross trade occurs when a person acts as an investment adviser in relation to a transaction in which such investment adviser, or any person controlling, controlled by, or under common control with such investment adviser, acts as broker for both such advisory client and for another person on the other side of the transaction.

The funds have different procedures with respect to completing principal and agency cross transactions that are set forth in each fund's operative documents. Accordingly, the portfolio managers are required to identify any potential principal transaction, and any potential agency cross trade between two or more funds, prior to effecting the transaction and to contact the firm's Chief Compliance Officer. The Chief Compliance Officer, in consultation with outside counsel (if necessary), will determine whether or not the trade would constitute a principal transaction or an agency cross trade, and if so, whether such transaction is permissible and what procedures must be followed to complete the transaction. The firm has the right to cause the funds to engage in agency cross trades, including the purchase or acquisition of participations in originated investments for purposes of rebalancing the portfolios of the funds or for other reasons consistent with the investment and operating guidelines of the funds. These rebalancing transactions, if effected, may or may not be subject to commissions. It is our more customary policy to rebalance funds and accounts by trading in the market rather than by effecting agency cross trades.

The funds may, from time to time, make an investment in a portfolio company in which one or more of Avenue's other clients invests in a different part of the capital structure. There may be instances where such a portfolio company may seek to take an action where the funds' and the other clients' interests in such portfolio company may conflict. Moreover, there may be situations in which a fund determines to invest in an issuer in which another fund managed by the firm or its affiliates maintains an investment. Furthermore, a fund may invest in the interests of another fund managed by the firm and/or its affiliate(s). See Item 8 ("Methods of Analysis, Investment Strategies and Risk of Loss – Risks Associated with the Firm's Investment Strategies – Conflicts of Interest – Investments Involving Other Clients"). To the extent that the funds hold securities in a portfolio company with rights, preferences and privileges that are different than those held by other clients in the same portfolio company, Avenue's Principals and their representative affiliates may be presented with decisions when the interests of the funds and the other clients are in conflict. It is possible that a fund's interests may be subordinated or otherwise adversely affected by virtue of the other clients' involvement and actions relating to their investment. Avenue has adopted procedures to address and, in some cases, mitigate the actual conflicts of interest that may arise. Exceptions to these procedures must be approved in advance by the Chief Compliance Officer.

In certain circumstances, the firm and its employees may receive discounted or complimentary goods or services provided from an investee company in which one or more funds invests. The firm's compliance manual addresses such practices in its policy regarding gifts, entertainment and investee company promotions.

The firm may, from time to time, recommend a security in which the firm, directly or indirectly, has an interest. For instance, it may be expected that one or more of the funds may invest capital in another of the funds or in securities of issuers in which one or more of the other funds hold positions. In addition, the general partners of certain of the funds have invested their own capital in their funds. Given the likely frequency of these occurrences, clients and investors in the funds will not be provided with notification of them. This may represent a conflict of interest for the firm.

We will not be engaged as an investment adviser to advise investors as to the appropriateness of investing in the funds or managed accounts we manage. Although we will not receive any compensation for selling interests in the funds, we will receive compensation in our capacity as manager of these funds based in part upon the amount invested in the funds. See Item 14 ("Client Referrals and Other Compensation – Compensation for Client Referrals; Placement Agents for Funds").

Accounts that are beneficially owned by the firm's employees, Principals and affiliates may from time to time transact in trade claims of distressed companies. These transactions will be subject to our personal account trading policy.

## Item 12. Brokerage Practices

### Selection of Brokers

In effecting securities transactions, the firm generally seeks to negotiate with brokers a combination of the most favorable commission and the best price obtainable on each transaction. Consequently, brokers are selected primarily on the basis of their execution capability and trading expertise consistent with the effective execution of the transaction.

In determining the broker or dealer to be used or the reasonableness of a commission rate or spread, the firm may consider one or more of the following (in addition to the commission rate or spread):

- the utility and reliability of brokerage services,
- execution capability and performance,
- financial condition,
- investment information,
- market insights,
- access to analysts and management, and
- idea generation.

In determining the appropriate broker-dealer to execute a transaction, certain other non-execution related factors, such as access to research and invitations to conferences, may also be included in the decision-making process. However, there is no express dollar amount attributable to non-execution benefits provided (*i.e.*, neither the firm nor the funds “pay up” to execute orders), and there is no written or verbal agreement or other *quid pro quo* understanding to provide order flow in exchange for such non-execution related goods and services. As such, these are not soft dollar or commission sharing arrangements (see below). Accordingly, the commissions charged by brokers may be greater than the amount another broker might charge if the firm determines in good faith that the amount of these commissions is reasonable in relation to the value of the brokerage services and research information provided by the brokers. The firm’s authority to select the broker or dealer to be used may be limited by legal restrictions such as those imposed under the U.S. Employee Retirement Income Security Act of 1974 (ERISA).

Consistent with the requirements of best execution, brokerage commissions may be directed to brokers in recognition of investment research and information furnished as well as for services rendered in the execution of orders by such brokers. By allocating transactions in this manner, the firm is able to supplement its research and analysis with the views and information of brokerage firms. The funds may also allocate a portion of their brokerage business to brokerage firms whose employees participate as brokers in the introduction of investors to the funds or who agree to bear the expense of capital introduction, marketing or related services by third parties.

The firm may effect securities transactions, to the extent permitted by law, with brokerage firms affiliated with the firm or with investment companies registered under the Investment Company Act of 1940 to which an affiliate of the firm provides advisory services, if it reasonably believes that the quality of execution and the commission are comparable to that available from other qualified firms.

## **Soft Dollar and Directed Brokerage Arrangements**

We do not currently engage in soft dollar arrangements, but we reserve the right to do so in the future. Notwithstanding the foregoing, certain non-execution products and services may be provided by executing brokers, including, without limitation, research, corporate access, and capital introduction events. There is no expectation of order flow or any agreement to “pay up” for these products or services, however, and the firm does not believe that these constitute soft dollar items. To the extent that soft dollars are used, any products or services acquired using soft dollars will be consistent with Section 28(e) of the Exchange Act of 1934.

During the most recent fiscal year, the firm did not use any soft dollar items or engage in directed brokerage transactions.

## **Aggregation of Orders**

If the firm has determined to purchase (or sell) an investment at the same time for more than one fund, the firm will generally place combined orders for all such funds simultaneously, and if all such orders are not filled at the same price, it will generally average the prices paid. Similarly, if an order on behalf of more than one fund cannot be fully executed under prevailing market conditions, the firm will allocate (or sell, as applicable) the investments among the different funds on a basis that it considers equitable. Situations may occur where the funds could be disadvantaged because of the investment activities conducted by the firm for other funds. From time to time, the firm may enter trades for funds managed by the firm’s affiliated investment advisers and such affiliates may enter trades for funds managed by the firm.

## **Allocation Procedures**

In addition to our responsibilities with respect to the management and investment activities of the funds and the managed accounts, we and our affiliates will have similar responsibilities with respect to various other existing pooled investment vehicles and managed accounts (such clients, together with clients of the firm, are referred to as “Avenue clients”). The existence of such multiple vehicles and accounts necessarily creates a number of potential conflicts of interest.

We expect that investments will be allocated between and among Avenue clients, particularly where the investment objectives and policies of the Avenue clients overlap (in whole or in part). There are, or are expected to be, differences between and among the Avenue clients, which may affect how a transaction is allocated with respect to, among other considerations:

- investment objectives,
- investment strategies,
- investment parameters and restrictions,
- portfolio management personnel,
- tax considerations,
- liquidity considerations of the investment as well as the funds,
- hedging considerations,
- legal and/or regulatory considerations,

- potential volatility of the investment,
- asset levels,
- fee levels,
- timing and size of investor capital contributions and redemptions,
- cash flow considerations,
- market conditions,
- existing exposures to an investee company's securities or other instruments, and
- other criteria we deem relevant (the nature and extent of the differences will vary from client to client).

In addition, certain investments may be purchased in odd lots, or there may exist stub amounts, either of which are not readily allocable to multiple clients. Notwithstanding the differences between and among Avenue clients, and the possible existence of hard to allocate investments, there may be circumstances where some or all of the Avenue clients participate in an aggregated order where we believe it is in the best interest of all Avenue clients participating in such order. In all such instances, we will assess whether the investment should be allocated on a *pro rata* basis, targeted net asset basis, targeted total asset basis, in the case of registered investment companies managed by an affiliate of the firm, on a total asset basis, or other basis.

The firm will not always allocate aggregated orders among Avenue clients on a *pro rata* basis. There will be circumstances where:

- only some of the Avenue clients participate in the aggregated order;
- the level of participation between and among the Avenue clients in the aggregated order is not on a *pro rata* basis; and/or
- investment transactions between and among the Avenue clients vary in other respects.

Such non-*pro rata* allocations of aggregated orders between and among the Avenue clients will be made in the discretion of Avenue when deemed:

- appropriate given the differences between the clients involved;
- appropriate because the target holdings of the particular investment that Avenue has established with respect to the clients involved differ from client to client; and/or
- otherwise to be in the best interests of the clients involved.

From time to time we may review Avenue clients' exposure to certain investments and determine exposure net asset value targets for clients or, in the case of registered investment companies managed by an affiliate of the firm, on a total asset basis. Where the exposure targets are used prior to entering a transaction, the firm may prepare a report that sets forth (i) the target exposures, on a net or total, as applicable, asset value basis, for certain clients with respect to specific investments and (ii) a consistent methodology for the allocation of transactions in these investments among these clients. After that, until the applicable asset value exposure targets are achieved or modified, purchases or sales, as applicable, in

the relevant investments (which will generally be made on an aggregated basis) will be allocated to Avenue clients in the amounts (expressed as a percentage of the aggregate amount purchased or sold) determined pursuant to the report rather than on a *pro rata* basis.

It is our general policy that no Avenue client will receive inappropriate preferential treatment or otherwise be treated unfairly; and we will seek to uphold this policy when making decisions regarding investment allocations.

In connection with certain funds' investment programs, the funds (along with other Avenue clients) have made and will make investments through special purpose entities domiciled in Luxembourg. These investments are typically made in Europe. The funds' offering documents provide that the funds shall bear all investment expenses. Each fund shall bear its allocable share of special purpose entity expenses associated with employees' salaries and office space rent in Luxembourg in accordance with the firm's expense allocation policy.

The public funds managed by an affiliate of the firm may invest in securities that are similar to investments that may be held by private funds managed by the firm and its affiliates. Where a particular investment would be eligible for investment both by a public fund and a private fund managed by the firm and/or its affiliates, or by both public funds, prior to purchasing such investment, the firm and its affiliates will prepare a report that sets forth the target exposures, on a net or total, as applicable, asset value basis, for the applicable public and private funds with respect to the identified investments (as determined for each fund by such fund's portfolio manager). Thereafter, until the applicable asset value exposure targets are achieved or modified, purchases or sales, as applicable, in the relevant investments (which will generally be made on an aggregated basis) will be allocated to the applicable public and/or private funds in the amounts (expressed as a percentage of the aggregate amount purchased or sold) proportionate to each fund's applicable asset value exposure target. When both public funds or a public fund and private fund participate in an aggregated trade on an investment with a net or total asset value target, to the extent such investments are allocated non *pro-rata*, such allocations must be approved, in advance, by the Chief Compliance Officer.

### **Trade Errors and Net Asset Value Computation Errors**

We have adopted a policy for the purpose of addressing trade errors that may arise, from time to time, with respect to the securities transactions of the private funds and the managed accounts. An example of a trade error is the sale of a security when it should have been purchased. Pursuant to the policy, we will seek to identify and correct any trade errors in an expeditious manner. Trade errors that result in losses for a private fund or managed account that are the result of our gross negligence or willful misconduct, as determined by us, will be reversed, and we will be responsible to make the affected funds and managed accounts whole. Trade errors that result in losses for a fund or managed account that are not the result of our gross negligence or willful misconduct, as determined by us, will be reversed and we may, but are not required to, bear such losses in whole or in part. Any such losses we do not bear will be borne by the affected funds and/or managed accounts. Gains from trade errors will be credited to the affected funds or managed accounts. Gains from trade errors may not be used to offset losses from trade errors. "Soft dollars" or "client commissions" will not be used, either directly or indirectly, to correct trade errors. We document each trade error and maintain a trade error file. The determination of whether or not a trade error has occurred will be in our sole discretion.

### **Item 13. Review of Accounts**

Each fund and managed account is maintained, supervised and reviewed on a regular basis by its respective investment principles. Matters reviewed include specific investments held, the percentage of assets in various types of asset classes and the relative and absolute performance of each account. The investment principles for each Avenue fund are listed in that fund's offering documents.

With respect to the funds for which the firm serves as the investment manager, each investor receives annual audited financial statements of each such fund. In addition, investors in the funds receive additional financial statements and reports as described in the offering documents for each fund.

With respect to other clients for whom we serve as the investment manager on a managed account or sub-advisory basis, we will provide such clients with reports and statements, the content and frequency of which will be as agreed.

### **Item 14. Client Referrals and Other Compensation**

#### **Compensation for Client Referrals; Placement Agents and Distributors for Funds**

The firm may in the future retain the services of one or more placement agents and distributors in connection with the solicitation of prospective investors. The firm does not presently retain any third-party placement agents or distributors.

### **Item 15. Custody**

We have custody, as defined in Rule 206(4)-2 under the Advisers Act, of the assets of the funds as a result of the service of certain of our affiliates as general partners of some of the funds and/or our ability to remove the independent directors of some of the funds. The funds are audited annually and deliver audited financial statements to their investors within 120 days' of the applicable fiscal year-end.

### **Item 16. Investment Discretion**

Item 4 includes a description of the investment discretion that we exercise.

### **Item 17. Voting Client Securities**

We have policies and procedures in place for the voting of proxies, processing of corporate actions and participating in class action lawsuits and related settlements on behalf of the funds and managed accounts we advise. The proxy policy is designed to ensure compliance with the proxy voting, disclosure and record keeping requirements under SEC Rules 206(4)-6 and 204-2 adopted under the Advisers Act. Our policies and procedures are also designed to ensure that all proxy and corporate action proposals are thoroughly reviewed and voted in the best interest of each fund, provide disclosure to fund investors and ensure that certain documentation is retained. As a general matter, clients may not direct our vote in a particular solicitation.

The Firm's objective is to ensure that its proxy voting and corporate action activities on behalf of the funds are conducted in a manner consistent, under all circumstances, with the best interest of the funds.

## **Proxy Voting**

With respect to certain proxy proposal issues, we vote in accordance with predetermined "for" or "against" designations, except when we determine the best interests of the client require a contrary vote. We vote other proxy proposals on a "case by case" analysis in the best interests of the client.

In the event that the firm votes contrary to the proxy voting guidelines, we will document the basis for our contrary voting decision.

In addition, the firm may choose not to vote proxies in certain situations or for certain funds, such as (i) where a fund has informed the firm that it wishes to retain the right to vote the proxy, (ii) where the firm deems the cost of voting would exceed any anticipated benefit to the fund, (iii) where the proxy is received for a fund that has been terminated, or (iv) where a proxy is received by the firm for a security it no longer manages on behalf of a fund. The firm will document the basis for the decision not to vote.

We may be subject to conflicts of interest in the voting of proxies. If at any time the firm becomes aware of an actual conflict of interest relating to a particular proxy proposal, the firm will handle the proposal as follows:

- If the proposal is designated in the proxy voting policies as "For" or "Against," the proposal will be voted by the firm in accordance with the proxy voting policies; or
- If the proposal is designated in the proxy voting policies above as "Case by Case" (or not addressed in the proxy voting policies), if it is clear how to vote in the best interest of the funds entitled to vote then the vote may proceed, otherwise, Avenue's Conflicts Committee will attempt to resolve the conflict of interest and will seek to resolve the conflict pursuant to the procedures set forth in "Conflict Resolution in Proxy Voting and Corporate Actions" below.

Each investor in a private fund and each managed account client may obtain information on how we voted with respect to the securities of such fund or managed account, as applicable, and obtain a copy of proxy voting policies and procedures by submitting a written request to Eric Ross at 399 Park Avenue, 6th Floor, New York, New York 10022 or by contacting Mr. Ross at 212-878-3500.

## **Corporate Actions**

Avenue has adopted procedures to address and, in some cases, mitigate the conflicts of interest that may arise with respect to corporate actions and proxy voting where multiple funds hold different securities of the same issuer. In cases where either a specific right, such as a vote with respect to a security or the grant of a waiver, or an ongoing right, such as an opportunity to serve on a creditor's committee or otherwise engage in discussions with an issuer, arises, and Avenue does not identify a conflict of interest, the following procedures will apply:

- Avenue will be responsible for determining whether the course of action that is in the best interest of the relevant fund is clear;
- Avenue will exercise the right or ongoing right in the best interest of the relevant fund(s); and



- The Chief Compliance Officer will be notified prior to the exercise of the right.

### **Conflict Resolution in Proxy Voting and Corporate Actions**

If Avenue identifies a conflict of interest with respect to corporate actions and proxy voting where multiple funds hold different securities of the same issuer, then Avenue will notify the Chief Compliance Officer and convene its Conflicts Committee to attempt to resolve the conflict. If the Conflicts Committee cannot do so, Avenue will follow the procedures set forth in each fund's organizational documents. The funds' organizational documents generally provide that an advisory committee established by the fund or independent representative appointed to handle such matters or, if permitted under the fund's organizational documents, an independent third-party, may vote on behalf of the fund.

### **Class Actions**

Avenue has adopted a policy with respect to the participation of its clients in class action lawsuits and related settlements. Avenue employs a third party that provides a list of outstanding class actions. Avenue's Compliance Department, along with the applicable Senior Portfolio Manager, review an internal report showing all Avenue investments for which Avenue clients may participate in a class action in order to determine whether participation in the class action is in the best interest of the Avenue clients. Avenue may determine that it may not be in Avenue clients' best interest to participate in a class action if, among other reasons:

- The Avenue clients have appointed a person to an interested party's Board of Directors;
- The Avenue clients are negotiating or may seek to negotiate a transaction with an interested party; or
- The level of resources that would need to be allocated to the class action effort is disproportionate to the perceived potential benefit to the Avenue clients.

In the event of a conflict of interest between or among Avenue clients in connection with a class action matter, the firm (and its affiliates, if applicable) will analyze the interests of the pertinent Avenue clients in order to determine the appropriate course of action (e.g., allowing the class action to proceed with respect to similarly situated Avenue clients and/or declining to participate in a class action on behalf of other similarly situated Avenue clients).

### **Item 18. Financial Information**

We do not require or solicit prepayment of more than \$1,200 in fees from the funds, six months or more in advance, and therefore are not required to include a balance sheet for our most recent fiscal year.