

**Part 2A of Form ADV: Firm Brochure**

March 31, 2023

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**This brochure provides information about the qualifications and business practices of Keyframe Capital Partners, L.P. If you have any questions about the contents of this brochure, please contact us at (212) 380-5800. 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.**

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

Though Keyframe Capital Partners, L.P. may refer to itself as a “registered investment adviser,” this statement does not imply a certain level of skill or training.

## **Material Changes**

This is an annual amendment to our previous brochure. We have included updated disclosure in Item 1 (RAUM), Item 4 (type of clients), Item 5 (additional risks), and Item 7 (disclosure relating to our affiliation with an investment advisor). We recommend that you read this brochure in its entirety.

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## **1. Advisory Business**

Keyframe Capital Partners, L.P. is a recently formed investment advisory firm which seeks to provide investment management services to single-investor investment vehicles which are funded by institutional investors or high net worth investors. Our firm also provides discretionary and non-discretionary sub-advisory services to Cyrus Capital Partners, L.P., a federally registered investment adviser, in connection with management of certain positions held by its private funds. Cyrus Capital Partners, L.P. provides a suite of infrastructure support services to the firm, including trading execution, back office services and compliance administration. The principal owner of the firm is John Rapaport.

Our firm provides discretionary and non-discretionary investment advisory services to our clients. Our investment strategies entail primarily investing across the capital structure of highly levered and financially distressed companies. We seek attractive absolute and relative returns that are not correlated to the general equity and fixed income markets, while also focusing on preserving capital. Fundamental value and credit analysis combined with our firm's experience with event catalysts and processes specific to leveraged and financially distressed companies drive our investment process.

Though our firm utilizes a similar strategy for most of our clients, we do occasionally tailor our advisory services to certain of our clients for legal and tax purposes.

Our firm does not participate in wrap fee programs.

As of January 31, 2023, our firm had discretion over \$739,314,000 in regulatory assets under management.

## **2. Fees and Compensation**

Our firm, or an affiliate of our firm, typically receives compensation from each of our clients based on both the percentage of assets we manage and performance-based compensation based on realized gains. We typically structure our performance-based compensation as profit-sharing allocations through general partner interests that our affiliate holds in our client funds. We structure our performance-based compensation as carried interest distributions received by our affiliate through general partner interests in our fund clients. Before our affiliates can receive any distributions of carried interest, however, our clients generally must receive a return of their capital contributions, plus a preferred return. We only offer interests in our client funds to "qualified purchasers" as defined in the Investment Company Act of 1940, as amended.

We deduct our asset-based fees directly from our clients' accounts each quarter, as applicable. We only receive performance-based compensation with respect to fund clients when investments are realized and gains are distributed.

The asset-based fee that we charge investors in relevant clients is payable at the beginning of each quarter. Since investors are not permitted to redeem interests in our fund clients, we charge asset-based fees only during the periods we provide services. In the unlikely event that the investment management agreement is terminated before the end of the billing period, we will refund a *pro rata* percentage of the fee paid in advance.

Investors in our clients do not pay any performance-based compensation in advance.

With respect to advisory services we provide to Cyrus Capital Partners, L.P. and its clients, we are paid a fixed-fee with respect to certain positions, asset-based fees quarterly in advance, subject to an equitable pro ration in the event of an early termination of the sub-advisory services agreement, and we can be allocated a portion of performance-based fees payable to Cyrus Capital Partners, L.P. by its clients.

All of our clients bear various costs, fees and expenses in addition to the compensation payable to our firm or an affiliate of our firm. All investors in our clients and prospective investors should review the private placement memorandum or other governing documents for each applicable fund, which discuss the particular expenses borne by that fund. However, below we provide a list of the investment and operating costs, fees and expenses that our clients typically incur:

- brokerage commissions and other transaction costs,
- clearing and settlement charges,
- custodial fees,
- foreign exchange and hedging related fees and expenses,
- margin expense,
- interest expense,
- commitment fees on debit balances or borrowings,
- borrowing charges on securities sold short,
- any issue or transfer taxes chargeable in connection with any securities transactions,

- consulting, legal and other professional fees relating to particular investments, including fees incurred in connection with due diligence and negotiating terms,
- research-related costs and expenses,
- travel expenses incurred in connection with due diligence,
- legal expenses, including those related to investments and fund governance, such as expenses of revising governing documents,
- systems and technology costs,
- market data and risk management expenses,
- external valuation expenses,
- accounting, audit and tax preparation expenses,
- administrative expenses, costs of holding any investor meetings, costs associated with the maintenance of the applicable fund's books and records, costs of preparing, reporting and providing information to, and otherwise communicating with, existing and prospective investors, expenses incurred in connection with administrative proceedings with respect to taxes, expenses incurred in connection with dissolution and liquidation and regulatory reporting and filings and other costs,
- organizational expenses, including legal and accounting fees, printing costs, travel, "blue sky" filing fees and expenses and out-of-pocket expenses,
- expenses relating to the offer and sale of interests/shares in the applicable fund,
- costs of liability insurance (including "directors and officers," "errors and omissions," and employment practices liability insurance),
- taxes, registration fees and other government charges incurred or paid by a fund (including under Sections 6221 through 6241 of the Internal Revenue Code of 1986, as enacted by the Bipartisan Budget Act of 2015, as amended from time to time, and the Treasury Regulations thereunder), as well as licensing fees,
- directors' fees (with respect to any clients that are organized as companies),
- any litigation or investigation costs related to their investment activities (including costs of any judgment or settlement amounts),

- indemnification expenses,
- regulatory costs, and
- extraordinary expenses.

The list of fees and expenses we have enumerated above does not necessarily contemplate every type of fee or expense our clients may incur.

If we determine that expenses were incurred for the benefit of more than one of our clients, we seek to allocate the expense in a manner that we determine is fair (which may be based on relative size or proposed size of a specific investment, relative account value or other criteria).

For more information on brokerage transactions and costs, please see Section 9: Brokerage Practices.

Neither our firm nor any of our principals or employees accepts compensation for the sale of securities or other investment products.

### **3. Performance-Based Fees and Side-By-Side Management**

Our firm (or one of our affiliates) receives performance-based compensation from all of our fund clients. We also are entitled to a share of the performance-based compensation that Cyrus Capital Partners, L.P. and/or its affiliates receive from its clients, in connection with our services to them. The existence of side-by-side client accounts that are subject to different performance-based compensation can give rise to a potential conflict of interest in that we may be incentivized to favor clients that are subject to the highest compensation. This conflict is minimized by the fact that all investment allocations are made in accordance with our investment allocation policy which prevents us from taking compensation into account when making investment allocation decisions.

### **4. Types of Clients**

Our firm provides investment advisory services to single-investor investment vehicles, the investors of which consist of private investment funds, investment vehicles which are owned by a single external investor and our employee vehicle (which is an investment vehicle whose investors are solely our employees that invests through these investment vehicles) and to another investment advisory firm.

To comply with Securities and Exchange Commission regulation, we require that U.S. investors in our funds qualify as both accredited investors and qualified purchasers.

We generally require investors in our single-investor fund clients (other than our

investment vehicle that is composed solely of our employees) to make capital commitments of at least \$25 million to \$60 million, as agreed upon with the underlying investor. Capital is drawn down in increments over specific time.

This firm brochure is not an offer to invest in our funds.



## 5. Methods of Analysis, Investment Strategies and Risk of Loss

Fundamental value and credit analysis combined with our firm's experience with event catalysts and processes specific to leveraged and financially distressed companies drive our investment process. We use a rigorous, fundamental, credit-intensive approach to identify and exploit inefficiencies in the leveraged and distressed debt and leveraged equities markets. Our investment process begins with bottom up, fundamental analysis of leveraged companies, which includes understanding how a company generates cash flow, determining the prospects of that cash flow stream and analyzing the various claims against that cash flow stream. In making investment decisions, we rely primarily on our own internal research, which includes knowledge we gain from relationships and contacts with the investor relations and management teams of a particular company, as well as with those of companies that supply goods or services to, compete with, or are customers of that company, all in accordance with applicable law. Notwithstanding the foregoing, however, we may at times obtain research from a third-party consultant, including of a political nature, subject to the Chief Compliance Officer conducting due diligence on such consultant and approving the relationship in advance.

Despite our methodology, investing in any securities involves a risk of loss that any of our clients or any of the investors in our clients must be prepared to bear.

The success of our investment activities depends on our ability to identify and capitalize on inefficiencies in the leveraged and distressed debt and leveraged equities markets. Identification and taking advantage of these opportunities involve uncertainty. We cannot assure any clients or investors that we will be able to locate investment opportunities or to correctly identify inefficiencies in the market. Certain risks associated with an investment in any client we advise include:

- *Investment Judgment and Market Risk:* The success of our investment programs depends, in large part, on correctly evaluating future price movements of potential investments. We cannot guarantee that we will be able to accurately predict these price movements and that our investment programs will be successful.
- *Third Party Information Risk:* We may select investments for our clients, in part, based on information and data that issuers file with governmental regulators or other public information that issuers make available to us. Although we evaluate all information and data and seek independent corroboration when appropriate and available, we are not in a position to confirm the completeness, genuineness or accuracy of the information and data, and, at times, complete and accurate information is not available. Investments may not perform as we anticipated if information is inaccurate.

- Cybersecurity Risk:* The information and technology systems of not only our firm but also our clients' portfolio companies or third-party service providers may be vulnerable to damage or interruption from computer viruses, network failures, computer and telecommunication failures, infiltration by unauthorized persons and security breaches, usage errors by their respective professionals, power outages and catastrophic events such as fires, tornadoes, floods, hurricanes and earthquakes. Although we have implemented, and portfolio companies and service providers have likely implemented, various measures to manage risks relating to these types of events, if these systems are compromised, become inoperable for extended periods of time or cease to function properly, our firm, our clients, portfolio companies and/or service providers, as applicable, may have to make a significant investment to fix or replace them. The failure of these systems and/or of disaster recovery plans for any reason could cause significant interruptions in our firm's, our clients', portfolio companies' and/or service providers' operations and result in a failure to maintain the security, confidentiality or privacy of sensitive data, including personal information relating to investors in our clients (and, to the extent applicable, the beneficial owners of investors). These failures could harm our firm's, our clients', a portfolio company's and/or a service provider's reputation, subject any of these entities and their respective affiliates to legal claims and otherwise affect their business and financial performance. A client and its investors could be negatively impacted as a result. While we have established business continuity plans and systems designed to minimize the risk of cyber-attacks through the use of technology, processes and controls, there are inherent limitations in such plans and systems, including the possibility that certain risks have not been identified given the evolving nature of this threat. Our clients rely on third-party service providers for many of its day-to-day operations and will be subject to the risk that the protections and protocols implemented by those service providers will be ineffective to protect a client from cyber-attack.
- COVID-19.* The coronavirus disease ("COVID-19") outbreak has created disruption in global demand and supply chains and contributed to significant volatility in financial markets. Generally, the COVID-19 outbreak has had, and could continue to have, a negative effect on the economies, financial markets and business activities of the United States and many other countries. COVID-19 has resulted in health or other government authorities requiring the closure of offices or other businesses, including office buildings, retail stores and other commercial venues. While businesses begin to reopen, potential future outbreaks of COVID-19 or the outbreak of new epidemics could result in more closures or sustained closures and further general economic decline. A resulting negative impact on economic fundamentals and consumer confidence may impact market value, increase market volatility, cause credit spreads to widen, and reduce liquidity, all of which could have an adverse effect on our

client's returns and the client's ability to source new investments. No assurance can be given as to the effect of these events on the value of the client fund's investments. Furthermore, such uncertainty or general economic downturn may have an adverse effect upon the client's investments..

- *Force Majeure Risk.* Companies may be affected by force majeure events (i.e., events beyond the control of the party claiming that the event has occurred, including, without limitation, acts of God, fire, flood, earthquakes, war, terrorism and labor strikes). Some force majeure events may adversely affect the ability of a party (including a company or a counterparty to one of our clients or a company) to perform its obligations until it is able to remedy the force majeure event. In addition, the cost to a company or one of our clients of repairing or replacing damaged assets resulting from such force majeure event could be considerable. Certain force majeure events (such as war or an outbreak of an infectious disease) could have a broader negative impact on the world economy and international business activities generally, or in any of the countries in which one of our clients may invest specifically. Additionally, a major governmental intervention into industry, including the nationalization of an industry or the assertion of control over one or more companies or its assets, could result in a loss to one of our clients, including if its investment in such company is canceled, unwound or acquired (which could be without what we consider to be adequate compensation). Any of the foregoing may therefore adversely affect the performance of one of our clients and their investments.
- *Conflict in Ukraine.* The conflict in Ukraine could have an adverse impact on our clients. In addition to the humanitarian and political crisis which is unfolding, the events are adversely impacting global commercial activity and have contributed to volatility in financial, currency and commodities markets. The regional and global impact of the conflict and ensuing crisis is rapidly evolving and could negatively affect the performance of our clients' investments and present material uncertainty and risk with respect to the overall performance and financial returns of our clients.
- *U.S. Government Sanctions and Intervention Risks.* Economic sanction laws in the U.S. may prohibit us and our professionals and/or our clients from transacting with or in certain non-U.S. countries and with certain individuals and companies. In the U.S., the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") administers and enforces laws, Executive Orders and regulations establishing U.S. economic and trade sanctions. Such sanctions prohibit, among other things, transactions with, and the provision of services to, certain foreign countries, territories, entities and individuals. These entities and individuals include specially designated nationals, specially designated narcotics traffickers and other parties subject to OFAC sanctions and embargo programs. The lists of OFAC prohibited countries, territories,

persons and entities, including the List of Specially Designated Nationals and Blocked Persons and the Sectoral Sanctions Identifications List, as such lists may be amended from time to time, can be found on the OFAC website. In addition, certain programs administered by OFAC prohibit dealing with individuals or entities in certain countries regardless of whether such individuals or entities appear on the lists maintained by OFAC. The enactment of new U.S. economic and trade sanctions could significantly restrict our clients' investment activities, or require the divestment of existing investments by our clients.

Additionally, a major U.S. governmental intervention into industry, including, newly implemented or modified tariffs or other trade agreements applicable to certain products, industries or countries, the nationalization of an industry, or the assertion of control over one or more industry sectors or related assets, could result in a loss to our clients, including if an investment of a client is canceled, unwound, acquired or otherwise adversely affected (which could be without what we consider to be adequate compensation). These types of interventions may significantly restrict the investment activities of our clients in certain industries or countries.

- *Stability of the Banking System.* Silicon Valley Bank ("SVB") has been a provider of credit finance to businesses in the technology industry amongst others, and to private equity, growth capital, venture capital and other funds which invest in those businesses. On March 10, 2023, the California Department of Financial Protection and Innovation shut down SVB and appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver of SVB's assets and liabilities. On March 12, 2023, the Federal Reserve Board, Secretary of the Treasury and FDIC jointly announced that, pursuant to a systemic risk designation, all deposits with SVB (as well as all deposits at Signature Bank), whether insured or uninsured, would be protected. Analogous events have unfolded in relation to SVB's UK subsidiary, which has since been acquired. In the immediate aftermath of the bank failures, customers of both SVB and Signature Bank experienced disruptions in their ability to access deposits and draw on credit facilities. By March 13, 2023, various assets and liabilities of the recently failed banks had been transferred to FDIC-operated bridge banks, which are fully operational. However, there still remains some uncertainty around the longer-term future of these bridge banks as potential sale options continue to be evaluated.

Following the shutdown of SVB and Signature Bank, a number of US regional banks suffered declines in their stock prices and needed to obtain access to additional funds. These events have led to uncertainty in financial markets and the business community as to the stability of the banking sector more generally. There have been fears that the situation is systemic rather than limited to a few smaller banks. Soon afterwards, some larger and more systemically significant banks in Europe, the US and Asia have

suffered stock price declines and in some cases stabilizing central bank action has been required. On 19 March 2023 UBS announced plans to acquire Credit Suisse following an earlier announcement by the Swiss central bank that it would extend emergency funding to Credit Suisse.

It is possible that systemic risk in the banking sector is higher than expected and that the current uncertainty will lead to more widespread disruption of the banking and broader financial sectors, or that other sectors and industries will be affected, including the technology sector in which our clients operate. Should any such disruption become widespread, this may pose a material risk to our client's performance.

The following is a description of the various strategies that we utilize in advising our clients and some important risks associated with each strategy. The following explanation of certain risks is not exhaustive, but rather highlights some of the more significant risks involved in our investment strategies. For a complete explanation of all relevant investment strategies and their associated risks, investors in our clients should also review each applicable client's private placement memorandum or other governing documents, which may contain additional explanations of strategies, risks and other related details not discussed below.

- *Private Debt and Equity Securities:* Investments in privately held, early-stage companies are inherently more volatile than investments in more mature businesses. Younger businesses are inherently fragile and easily affected by both internal and external forces. New, private companies can lose much or all of their value suddenly in response to even one internal or external adverse event. On the other hand, immature businesses can gain suddenly in value in response to an internal or external positive development.

Significantly, typically less publicly available information exists concerning private companies than for larger, more established businesses, and our clients rely on our ability to obtain adequate information to evaluate the potential returns from investing in these companies. If we are unable to uncover all material information about these companies, we may not make a fully informed investment decision, and a client may lose money on its investments. Private companies may have limited financial resources and may be unable to meet their obligations under their loans and debt securities that a client may hold, which may be accompanied by a deterioration in the value of any collateral and a reduction in the likelihood of a client realizing the proceeds of any collateral or any guarantees that we may have obtained in connection with a client's investment. In addition, private companies' securities typically are not traded in the volumes typical for larger companies, and

it may take longer to sell private securities or a client may have to accept potentially less favorable prices if selling a position. Ultimately, investing in private companies, especially those with limited operating histories, is more speculative and entails greater risk than does investing in public companies with established operating records.

- *High Yield, Low-Rated or Unrated Securities:* Debt securities (including bonds) and preferred stock in which we invest on behalf of our clients may or may not be rated by credit rating agencies. If they are rated, their ratings may range from the very highest to the very lowest. Securities rated below investment grade normally provide a yield that is significantly higher than that of investment grade securities, but are quite speculative for reasons enumerated below. The lower-rated categories include debt securities that are in default and debt securities of insolvent issuers. The rating that a credit rating agency assigns to a security does not reflect an assessment of the volatility of the security's market value or the liquidity of an investment in the security. The values of lower-rated securities (including unrated securities of comparable quality) fluctuate more than those of higher-rated securities because investors generally believe that there are greater risks associated with them. In addition, the lower rating reflects a greater possibility that the financial condition of the issuer, or adverse changes in general economic conditions, or both, or an unanticipated rise in interest rates, may impair the ability of the issuer to make payments of principal and income. The inability (or perceived inability) of issuers to make timely payment of interest and principal would likely make the values of our clients' securities more volatile and could limit our ability to sell the securities at prices approximating the values we had placed on the securities. In general, the market for lower-rated or unrated securities is smaller and less active than that for higher-rated securities, which can adversely affect our ability to sell these securities at favorable prices. In addition, the market prices of lower-rated securities are likely to be more volatile because: (1) an economic downturn or increased interest rates may have a more significant effect on the yield, price and potential for default; (2) past legislation has limited (and future legislation may further limit) investment by certain institutions in lower-rated securities or the tax deductibility of the interest by the issuer, which may adversely affect the value of the securities; and (3) it may be difficult to obtain information about financially or operationally troubled issuers. We will not necessarily dispose of a security when its rating is reduced below its rating at the time of purchase.
- *General Risks Associated with Credit Strategies.* We will invest in some credit instruments issued by distressed and bankrupt issuers, including debt obligations that are in covenant or payment default. Evaluating reorganizations and bankruptcies can be a complex, time consuming and expensive process that

requires specialized expertise. Although such investments have the potential to achieve significant returns, they involve a high degree of risk and may fail to show any return for a considerable period of time or result in substantial or complete loss. There is no assurance that we will accurately evaluate the prospects for a profitable return on a client's investments. While exit from distressed trading strategies may come through recovery and/or appreciation and subsequent sale in financial markets, other means of exit take alternate and sometimes suboptimal forms, including, but not limited to: (i) a refinancing, sometimes providing for redemption of positions held by a client; (ii) reset terms and conditions, including but not limited to a longer tenure and/or a diminished coupon; (iii) conversion of debt instruments to further subordinated debt, hybrid or equity securities; (iv) sale of the entire company to a strategic or financial buyer; (v) government nationalization; (vi) liquidation of assets or creation of liquidation trusts for assets and (vii) cash settlement of claims from others involved in restructuring.

Certain of these exit strategies may go beyond the expected tenure of the trading strategy and adversely impact liquidity, volatility and pricing. Many of the events within a bankruptcy case are adversarial and often beyond the control of creditors. There can be no assurances that a client will be able to adequately exercise and/or enforce its full rights under the stated terms of its investments or that any actions taken by such client will be either beneficial or not harmful to final recovery value. In some situations, the market of available dealers for distressed positions may constrict and could impact the willingness to purchase or repurchase at an expected or modeled fair market value. Consequently, we may sometimes exit positions at times or under conditions different than initially anticipated and accept substantial losses.

- *General Market and Credit and Interest Rate Risks.* Debt instruments are subject to general market and credit and interest rate risks. Credit risk refers to the likelihood that an obligor will default on the payment of principal, interest or other amounts owed on an instrument. Financial strength and solvency of an obligor are the primary factors influencing credit risk. In addition, lack or inadequacy of collateral or other assets expected to be the source of repayment or credit enhancement for a debt instrument may affect its credit risk. Credit risk may change over the life of an instrument and debt instruments that are rated by rating agencies are subject to downgrade at a later date.

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 obligations) or directly (especially in the case of instruments whose rates are adjustable). In general, rising interest rates will

negatively affect the price of a fixed rate debt instrument and falling interest rates will have a positive effect on the price of a fixed rate debt instrument. 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.

- *Distressed Debt and Securities:* Distressed debt refers to non-performing and/or underperforming loans that are available for purchase on the secondary markets, as well as forms of securities (including bonds) issued by a company that is undergoing bankruptcy or reorganization or is likely to do so in the near future. Distressed bonds will have low ratings as discussed above. The debt and debt securities of distressed corporations are often overly discounted by the market, as risk adverse investors tend to sell securities due to an actual or potential bankruptcy filing. These situations can create attractive buying opportunities for investors specializing in valuing distressed debt and securities. We purchase these instruments on behalf of our clients with the anticipation that the company will emerge from its financial difficulties and become profitable again. In the interim, the purchase of the debt may allow the shareholders or bondholders to actively participate in the process of reorganizing the company as it attempts to position itself for a return to profitability. The risk of investing in distressed debt and securities is that the subject company's projected performance never takes place. When this is the case, the investments that we bought on behalf of our clients may become worth less than the amount initially paid for them, resulting in a loss. In some instances, however, particularly in the case of senior debt and other preferred claims, the ability to realize upon these claims successfully during a liquidation may also turn out to be profitable investment opportunities.

On the other hand, when investing in distressed debt, the amount and timing of payments, if any, by the debtor can be uncertain. Receiving late or incomplete loan payments can adversely affect our clients' return.

Significantly, on our clients' behalf, we, at times, participate more actively in the affairs of a distressed issuer than is typical of investors. A heightened level of involvement may make our clients more vulnerable to litigation risks or prevent them from being able to sell their securities at certain times.

- *Bank Loans and Participations:* At times, we invest in bank loans on behalf of our clients. Investing in bank loans involves unique risks such as: (1) the possible



invalidation of an investment transaction as a fraudulent conveyance to defer, hinder or defraud creditors under creditors' rights laws; and (2) environmental liabilities that may arise with respect to collateral securing the loans. In addition, participating in loans exposes our clients to potential lender liability claims, which are claims under which borrowers allege that their lenders are not treating them fairly. Lender liability claims are based on the premise that a lender has violated a duty of good faith and fair dealing owed to a borrower or has assumed a degree of control over a borrower resulting in the creation of a fiduciary duty owed to the borrower or its other creditors or shareholders.

Our clients would bear the costs of any successful claims by third parties that arise from these and other risks. Also, when investing in loans, there is always a risk that the borrower may default.

- *Loans of Portfolio Securities:* We may lend our clients' portfolio securities or enter into other transactions constituting loans of their assets. By doing so, we attempt to increase our clients' income by receiving interest on the loans. Should the borrowing party become insolvent and/or go into bankruptcy, we may experience delays in recovering the securities our clients lent. If the value of the securities our clients lent increases, our clients could experience losses if they are unable to recover the securities.
- *Bridge Loans:* We may lend our clients' funds on a short-term, unsecured basis to portfolio companies that are about to commence an initial public offering. In return, our clients typically receive discounted shares in the portfolio company after the public offering occurs. However, for reasons beyond our control, our clients may not always receive what they are expecting in return and their bridge loans may remain outstanding. In this case, the interest rate or terms of the loan probably will not adequately reflect the risk associated with the unsecured position that our client took.
- *Mezzanine Loans:* On our clients' behalf, we may invest in mezzanine loans from time to time. Mezzanine loans are an option a company might utilize when its real property is already being used to secure a primary loan, but the company has a need for a secondary loan. This type of loan is secured not by the real property, but by the stock belonging to the company that owns the property. Companies generally use mezzanine loans when they have to raise a large amount of money for expansions or for other types of large expenditures.

There are certain risks associated with investing in mezzanine loans. First, it is likely that our clients' mezzanine investments will be subordinate to the borrower's more senior debt, and if the borrower defaults under the more senior loan, the

lenders of the more senior loan will have preferential claims over those of our clients. In this case, the borrower's assets would first be used to repay the senior lender, so there is the risk that all or substantially all of the borrower's assets will be unavailable to repay our clients and other subordinate lenders. In addition, if we attempt to enforce a borrower's obligations on behalf of our clients, our clients could be subject to a borrower's claims of breach of contract or other unfair lending claims. If a borrower goes bankrupt, our clients also run the risk of being roped into bankruptcy proceedings which can be costly and lengthy. Lastly, there can be no assurance that a borrower will repay its mezzanine loans or that we, on our clients' behalf, will ultimately be able to collect on any of the collateral pledged for the loans.

- *Structured Loans.* We may make structured loans to companies, including companies experiencing financial trouble or those undergoing significant change or expansion. Such loans involve a substantial degree of risk as such loans are likely to be below investment grade. Such loans are typically expected to be term loans. We may also invest directly or through participations in loans with revolving credit features or other commitments or guarantees to lend funds in the future. Failure to advance requested funds to a borrower could result in claims against a client and in possible assertions of offsets against amounts previously lent. A client's investment in loans may include asset-based loans, commercial loans, bridge loans and debtor-in-possession financings.

A client may lose the entire value of a loan, may be required to accept cash or securities with a value less than the loan and/or may be prohibited from exercising certain rights. Moreover, investing in loans may be adversely affected by state and federal laws relating to, among other things, fraudulent conveyances, voidable preferences, lender liability and the bankruptcy court's discretionary power to disallow, subordinate or disenfranchise particular claims, and may also involve substantial litigation. We may invest in secured or unsecured loans. There is no assurance that the value of the collateral for secured loans will be sufficient to protect all or a portion of investment.

- *Prepayment Risk.* Loans are generally prepayable in whole or in part at any time at the option of the obligor at par plus accrued and unpaid interest thereon, and occasionally plus a prepayment premium. Prepayments on loans may be caused by a variety of factors which are often difficult to predict. Consequently, there exists a risk that loans purchased at a price greater than par may experience a capital loss as a result of such a prepayment. When credit market conditions become more attractive to obligors, the rate of prepayment of assets would be expected to increase as obligors refinance to take advantage of such improved conditions, which may negatively impact our investment returns.

- *Maturity Risk.* We may invest in loans for which most or all of the principal is due at maturity. The ability of the obligor(s) under such loan to make such a large payment upon maturity typically depends upon its ability to refinance the loan prior to maturity. The ability of an obligor to consummate a refinancing will be affected by many factors, including the availability of financing at acceptable rates to such obligor, the financial condition of such obligor, the marketability of the collateral (if any) securing such loan, the operating history of the obligor and related businesses, tax laws and prevailing general economic conditions. Additionally, middle market obligors generally have more limited access to capital and higher funding costs, may be in a weaker financial position, may need more capital to expand or compete, and may be unable to obtain financing from public capital markets or from more traditional sources, such as commercial banks. Consequently, the obligor may not have the ability to repay the loan at maturity and, unless it is able to refinance such loan, it could default in payment at maturity, which could result in losses.
- *Vendor Financing:* We may invest our clients' assets in portfolio companies that engage in vendor financing, meaning they lend money to their customers so that the customer can buy products from them. Vendor financing is risky because the customers that companies lend money to usually are not very financially stable and may never pay back the money. If the customers do not pay back the debt, the portfolio company will have to write-down the loss as a bad debt, decreasing the value of the portfolio company and its securities.
- *Trade Claims:* Trade claims are unsecured rights of payment arising from obligations other than borrowed funds. Trade claims include vendor claims and other receivables that are adequately documented and available for purchase from high yield broker-dealers.

The performance of trade claims depends in part on the obligor's current financial condition, competitive position in its industry and strategic direction. Investors in trade claims are also exposed to the risk of dilution, which occurs when the amounts invoiced by the obligor are reduced for reasons other than payment or default (for example, the return of goods, invoice errors, product disputes over quantity, quality or delivery). Finally, as with all debt investments, the risk exists that the obligor may default on its payments.

- *Structured Credit Products.* We may invest in structured credit products, such as collateralized debt obligations ("CDOs"), synthetic credit portfolio transactions and asset-backed securities. Synthetic portfolio transactions may be structured with two

or more classes or tranches that receive different proportions of the interest and principal distributions on a pool of credit assets. The yield to maturity of a tranche may be extremely sensitive to the rate of defaults in the underlying reference portfolio. A rapid change in the rate of defaults may have a material adverse effect on the yield to maturity. Structured product securities in which the clients invest may include securities that are subject to legal or contractual restrictions on their resale or for which there is a relatively inactive trading market. Securities subject to resale restrictions may sell at a price lower than similar securities that are not subject to resale restrictions.

- *Collateralized Debt Obligations.* We may invest in CDOs. CDOs are securitized interests in pools of generally non-mortgage assets. Collateralized debt obligation pools are split into different risk classes, or tranches, with “senior” tranches being the least risky. Interest and principal payments are made in order of seniority, so that junior tranches cost less and get paid more to compensate for additional risk. Holders of CDOs only receive payment when the underlying borrowers make payments, otherwise the holders have no other recourse against the pool. If distributions on the CDO collateral are insufficient to make payments on the CDOs, no other assets will be available for payment of the deficiency and, following realization of the CDOs, the obligations of such issuer to pay such deficiency generally will be extinguished.
- *Misrepresentation:* When investing in any type of loan, the risk exists that a borrower made a material misrepresentation or omission in the process of obtaining the loan. This inaccuracy or incompleteness can adversely affect the valuation of the collateral underlying the loan and/or can adversely affect our ability to perfect or effectuate a lien on the collateral securing the loan.
- *Effect of Regulatory Changes on the Debt Market:* Proposed and recently-enacted regulatory changes may have an adverse effect on investments in debt. Such legislation, if enacted, may reduce both the availability and desirability of such debt investments, resulting in an adverse impact on our investment strategy.
- *Convertible Securities:* Convertible securities are bonds, debentures, notes, preferred stocks or other securities that can be converted into or exchanged for a specified amount of common stock of the same or a different issuer within a particular period of time at a specified price or formula. The holder of a convertible security typically receives interest or a dividend until the security matures or is converted or exchanged. Convertible securities are unique in that they generally (1) have higher yields than common stocks, but lower yields than comparable non-convertible securities; (2) are less subject to fluctuation in value than the underlying security due to their fixed-income characteristics; and (3) provide potential for capital appreciation if the market price of the underlying security increases.

The value of a convertible security is a function of its “investment value” and its “conversion” value. A convertible security’s investment value is determined by its yield in comparison to yields of other securities of comparable maturity and quality that do not have a conversion privilege. Changes in interest rates influence a convertible security’s investment value, as investment value declines as interest rates increase and vice versa. The issuer’s credit standing and other factors may also affect the convertible security’s investment value. A convertible security’s conversion value is determined by the market price of the underlying security. If the conversion value is low relative to the investment value, then the investment value principally governs the price of the convertible security. As the market price of the underlying security approaches or exceeds the conversion price, the conversion value will increasingly influence the price of the convertible security.

A convertible security generally will sell at a premium over its conversion value by the extent to which investors place value on the right to acquire the underlying security while holding a fixed-income security. Typically, the amount of the premium decreases as the convertible security approaches maturity.

A convertible security may be subject to redemption at the issuer’s option. If one of our clients’ accounts holds a convertible security that its issuer redeems, this could adversely affect our client’s ability to achieve its investment objective.

- *Short Selling:* Short selling of securities occurs when we borrow securities, promising to buy them at a later date. If the price drops, we can buy the securities at the lower price and make a profit on the difference. If the price of the securities rises, we have to buy them back at the higher price, and the investment loses money. Buying the securities can itself cause the price of the securities to rise further which would exacerbate the potential for loss.
- *Capital Structure Arbitrage:* We may engage in capital structure arbitrage on our clients’ behalf. This investment strategy seeks to identify and exploit the relationships between price movements in different securities and instruments within a single issuer’s capital structure (for example, between senior debt and common stock or between subordinated debt and preferred stock). In this scenario, we buy an issuer’s undervalued security and sell short the same issuer’s overvalued security, or vice versa. The ultimate goal is for the market values of the different securities to converge, however, if instead they go in opposite directions, our client may incur substantial losses.
- *Relative Value Arbitrage:* When we engage in relative value arbitrage, we seek to take advantage of relative pricing discrepancies between various instruments, including equities, debt, options, swaps and futures. Relative value arbitrage

generally involves purchasing and selling two securities simultaneously to derive returns from the relationship between the two related securities rather than from the direction of the market. Of course, the risk exists that the price differential we attempt to exploit could change unfavorably, causing a loss. The prices of these investments can be volatile and market movements are difficult to predict.

- *Absolute Value Investing:* Absolute value investing involves taking advantage of price inefficiencies by purchasing securities that we believe are undervalued. However, there are no assurances that the securities will in fact be undervalued. In addition, our clients may need to hold the securities for a long time before realizing their anticipated value. During this period, a portion of our clients' funds will be committed to these securities, thus possibly preventing our clients from investing in other opportunities.
- *Hedging Transactions:* At times, we employ hedging techniques, seeking to reduce a portfolio's vulnerability to various risks. Hedging entails determining certain risks in one's portfolio and making trades seeking to offset those risks. Hedging against a decline in the value of a portfolio position does not eliminate fluctuations in the values of portfolio positions or prevent losses if the values of these positions decline, but rather it establishes other positions designed to gain from those same developments, moderating the decline in the portfolio positions' value. On the other hand, hedging transactions also limit the opportunity for gain if the value of the portfolio position should increase.

The success of a client's hedging strategy is subject to our ability to correctly assess the degree of correlation between the performance of the instruments used in the hedging strategy and the performance of the investments in the portfolio being hedged. There is a risk that we may not always choose the right variable to hedge against. Also, it is important to note that we may not always choose to hedge against, or might not anticipate, certain risks, and, our clients' portfolios will always be exposed to certain risks that cannot be hedged.

Loss of the ability to hedge, from either a change in the law or an inability to borrow a security when necessary, may result in losses to our clients from the resulting unhedged exposure or depreciation in the retained instrument's value.

Many other investment strategies we employ can be used as hedging techniques, such as options, futures, forwards, swaps and short selling.

- *Fixed-Income Securities:* We invest in bonds or other fixed-income securities on behalf of our clients. Fixed-income securities provide periodic returns and the eventual return of the principal at the end of the term. The value of fixed-income securities changes in response to interest rate fluctuations and market perception of

the issuer's ability to pay off its obligations. Fixed-income securities are also subject to the risk that their issuer may be unable to make interest or principal payments on its obligations.

- *Swaps and Other Derivatives:* At times, we invest in swaps and other forms of derivative contracts on behalf of our clients. A derivative is a financial instrument that is a contract between two parties, the value of which is linked to another security or commodity, or an "underlying asset." Most of the derivatives in which we may trade are over-the-counter, meaning they are privately negotiated between two parties, as opposed to being traded on an exchange. Over-the-counter transactions typically involve significant transaction costs.

A swap is a type of derivative in which counterparties agree to exchange one stream of cash flow for another, each stream being based on an underlying asset. For example, an investor realizing returns from an equity investment can swap those returns into less risky fixed income cash flows without having to sell its equities. Swaps are particularly sensitive because various market variables affect the values of the cash flows, causing them to fluctuate. Specifically, we tend to invest in credit default swaps and debt-for-equity-swaps, described below.

Any derivative contract typically involves leverage, as it exposes our clients to potential gain or loss from a change in the price of an underlying asset in an amount that exceeds the amount of cash or assets required to establish or maintain the derivative contract. Consequently, an adverse change in the price of the underlying asset can result in a loss to our clients that is more exaggerated than would have resulted from an investment that did not involve the use of leverage inherent in a derivative contract. Finally, derivative contracts are risky because, ultimately, their success depends in part on the counterparty's financial condition; that is, the counterparty's ability to turn over the cash flow it promised.

A discussion of some of the particular types of derivative contracts in which we invest follows below.

- *Credit Default Swaps:* A credit default swap is a contract between two parties under which they both agree to isolate and separately trade the credit risk of at least one third-party entity. Essentially, the buyer of a credit default swap receives credit protection, and the seller of the swap guarantees the credit worthiness of the product. For example, the buyer of a credit default swap would be entitled to the par value of a bond by the seller of the swap, should the bond default in its coupon payments. On behalf of our clients, we may use credit default swaps to hedge a portion of the default risk on a single corporate bond, a portfolio of bonds or a set index of bonds.

We also may use credit default swaps to implement a portfolio manager's theory that a particular credit or group of credits will experience credit improvement. In this case, the client would sell credit default protection under which it would receive a premium to take on the risk. Conversely, a client may purchase credit default protection even if it does not own the referenced instrument if we believe there is a high likelihood of credit deterioration. In certain circumstances, we may, on behalf of a client, acquire a credit default swap on a loan, a security or a basket of loans or securities that the client does not own. In such circumstances, the client would not offset any liabilities versus the securities owned. In certain instances of issuer defaults or restructurings, it has been unclear under standard industry documentation whether or not a "credit event" triggering the seller's payment obligations has been triggered. That ambiguity may lead to litigation or deprive the client of the ability to realize the full value of the swap.

The regulation of swaps has undergone significant change in the United States and Europe. The Commodity Futures Trading Commission has required a substantial portion of swaps (currently limited to interest rate swaps and index credit default swaps) that were historically executed on a bilateral basis in the over-the-counter markets to be cleared and potentially executed through a securities, futures or swap exchange or execution facility. Other classes of swaps are expected to be subject to clearing or "made available to trade" determinations in the future by either the Commodity Futures Trading Commission or the Securities and Exchange Commission. This clearing requirement may affect our ability to negotiate individualized terms on our clients' behalf and could increase the costs of entering into these derivative transactions by increasing margin or capital requirements. In addition, the Commodity Futures Trading Commission as well as prudential banking regulators including the Federal Reserve require the collection of initial and variation margin relating to swaps that are not required to be cleared.

In addition, in accordance with the requirements of the Dodd-Frank Act, the Commodity Futures Trading Commission previously proposed position limits applicable to swaps that are economically equivalent to United States-listed futures and futures options contracts, as well as a requirement for exchanges to set limits on contracts on non-physical commodities (for example, rates, currencies, equities and credit default swaps), and aggregate position limits for a broad range of derivatives contracts based on the same underlying commodity, including swaps. While certain persons, contracts



or transactions or classes thereof would be exempt from the speculative position limit requirements, if these position limits are re-proposed and adopted, the swap positions that we may take on behalf of our clients may be subject to limits on the size of the positions we can enter into.

European regulations governing swaps may also result in increased costs and reduced liquidity in these positions.

The possibility exists that the counterparty may not have the financial strength to abide by the contract's provisions. The leverage involved in many credit default swap transactions, and the possibility that a widespread downturn in the market could cause massive defaults and challenge the ability of risk-buyers to pay their obligations, both add to the uncertainty of an investment in these instruments. Credit default swaps that are not cleared are subject to increased risk of default.

- *Debt-For-Equity Swaps:* A debt-for-equity swap is a refinancing deal in which a debt holder of a company receives an equity position in the company in exchange for cancellation of the debt. Essentially, in debt-for-equity swaps, the creditors end up acquiring the portfolio company through this exchange. The primary risk inherent in a debt-for-equity swap is the ultimate failure of the acquired company. In that event, the former creditors, now equity holders, would lose their investment, especially if the company were liquidated in a bankruptcy.
- *Options:* There are certain risks associated with the sale and purchase of options. We invest in call and/or put options on our clients' behalf. Call options are the right to buy a security at a certain price within a defined time period. Put options are the right to sell a security at a certain price within a defined time period. A buyer of either type of option assumes the risk of losing its entire investment in the option. A buyer of a call option risks losing its investment if the particular security never reaches the designated price within the set time period. A buyer of a put option risks losing its investment if the particular security does not decline enough to reach the designated price within the set time period.

Not only will we buy and sell traditional equity stock options on behalf of our clients, but we may buy and sell options on futures and forward contracts as well (futures and forward contracts discussed below).

- *Option Writing:* Our clients may write (sell) covered call and put options on securities. The applicable client receives a premium from writing a call

or put option, which increases the client's return if the option expires unexercised or is closed out or exercised at a net profit. When a client writes a call option, it gives up the opportunity to profit from any increase in the price of a security above the exercise price of the option; when it writes a put option, the client takes the risk that it will be required to purchase a security from the option holder at a price above the current market price of the security.

- *Warrants:* Warrants are derivative instruments that entitle the holder to buy the underlying stock of the issuing company at a fixed exercise price until an expiration date. Warrants are similar to options (discussed above), except that warrants are typically attached to bonds or preferred stock and usually have longer exercise windows. Warrants typically can be detached from bonds or stock and sold separately. Warrants do not carry with them the right to dividends or voting rights with respect to the securities that they entitle the holder to purchase, and they do not represent any rights in the assets of the issuer. As a result, warrants may be considered more speculative than certain other types of equity-like securities. In addition, the values of warrants do not necessarily change with the values of the underlying stock and warrants cease to have value if they are not exercised prior to their expiration dates.
- *Futures:* A future, also known as a futures contract, is a contractual agreement to buy or sell a particular commodity or financial instrument at a pre-determined price in the future. At times, futures may be illiquid investments because certain commodity exchanges limit fluctuations in particular futures contract prices during a single day. Once the price of a futures contract has increased or decreased by an amount equal to the daily limit, that contract cannot be traded unless traders are willing to trade it within that limit. This could prevent us from promptly selling unfavorable contracts and thus would subject our clients to substantial losses. There is also the risk that an exchange or the Commodity Futures Trading Commission may suspend trading, order immediate liquidation or settlement in a particular contract. This could also prevent us from promptly selling unfavorable contracts.

Sometimes, we may ultimately settle the differences in a futures contract for cash, rather than delivering or receiving the underlying commodity or financial instrument.

- *Forwards:* A forward, or a forward contract, is a contract between two parties to buy or sell an asset at a specified future date at a price agreed upon

at the time the contract is made. It is very similar to a futures contract, except forward contracts are negotiated privately and are not traded on an exchange, and thus, are not subject to limitations on daily price moves. On the other hand, this means that there is not a big secondary market for forwards, which means they may be difficult to sell should they become unfavorable for our clients.

- *Reverse Repurchase Agreements:* We may, at times, enter into reverse repurchase agreements on behalf of our clients. Under a reverse repurchase agreement, a client sells securities yet also agrees to repurchase them at an agreed upon date and price. Reverse repurchase agreements involve the risk that the value of the securities sold may decline, yet the client must still repurchase them. On the other hand, these transactions also involve the risk that the other party to a reverse repurchase agreement will be unable or unwilling to complete the transaction as scheduled, which may result in losses to our client.
- *Investing in Highly Leveraged Portfolio Companies:* Because our clients' investments may include securities of companies that are highly leveraged, our clients may be subject to increased exposure to adverse economic factors, such as an increase in interest rates, a downturn in the economy or further deterioration in the economic conditions of portfolio companies or their industries. Similarly, we may invest our clients' assets in companies that are unable to generate sufficient cash flow to meet principal and interest payments on their indebtedness. Accordingly, the value of a client's investment in these companies could be significantly reduced or even eliminated due to further credit deterioration.
- *Foreign Securities:* At times, we buy and sell foreign securities for our clients' accounts. In fact, one of our clients focuses its investments in leveraged and distressed companies based in Europe. Investing in foreign securities involves certain risk factors not typically associated with investing in U.S. securities, such as fluctuation between exchange rates and the costs of converting from one currency to another. An increase in the value of the U.S. dollar compared to other currencies in which we may make investments will reduce the effect of increases and magnify the effect of decreases in the prices of securities our clients own.

In addition, there may not be much information available regarding foreign securities because foreign companies and governments may not be subject to accounting, auditing and financial reporting standards and requirements comparable to those of the U.S. There also might be a greater risk of political, social or economic instability and the possibility that foreign taxes may be imposed on our clients' income. Additionally, when investing in foreign bonds, there is always a

risk that their issuer will default and be unable to pay the interest and/or principal payments due on the bonds, as the financial stability of foreign issuers may be more precarious than that of U.S. issuers.

Finally, non-U.S. markets have different clearance and settlement procedures which, in some markets, have difficulty keeping pace with large volumes of transactions. This can lead to substantial delays and settlement failures that could adversely affect our clients' performance.

- *Investing in Emerging Markets:* We may invest in securities of issuers located in emerging markets on behalf of our clients. Emerging markets are countries that are less developed than the United States but whose social and economic activity is in the process of reform and is experiencing growth and industrialization. Risks associated with investing in some emerging markets include less publicly available information, less strict securities market regulation, less efficiency, less favorable tax provisions, a greater likelihood of severe inflation, unstable currency and war. Furthermore, due to quality and reliability concerns, official data published by the government or securities exchanges in emerging markets may not accurately reflect the actual circumstances being reported.
- *Illiquid Investments:* On behalf of our clients, we will make illiquid investments or make investments that become illiquid. Illiquid investments are investments that are not heavily traded and cannot easily be converted to cash, including investments in private companies. Investors in our client funds are not permitted to withdraw their interests and will be required to bear the risk of illiquid investments through their realization.
- *Lack of Diversification.* Our clients' assets may be highly concentrated in one or a few investments. Any lack of diversification would increase the risk of loss to a client if there is a decline in the market value of any security in which our firm, on behalf of our client, had invested a large percentage of our client's assets.

Our firm does not recommend primarily any single type of security. Our clients' investments are rather diversified, yet we still encourage our investors to consider all of the risk factors we have explained, in addition to those we provide in the private placement memoranda and other governing documents of our client funds, as any investment can be risky and investors must be prepared to assume any potential loss.

## **6. Disciplinary Information**

Neither our firm, nor any of our directors, officers or principals has been involved in any investment-related criminal or civil actions in a domestic, foreign or military court that

would be material to an evaluation of our firm's advisory business or the integrity of our firm's management.

Neither our firm, nor any of our directors, officers or principals has been involved in any administrative proceedings before the Securities and Exchange Commission, any other federal regulatory agency, any state regulatory agency or any foreign financial regulatory authority that would be material to an evaluation of our firm's advisory business or the integrity of our firm's management.

Neither our firm, nor any of our directors, officers or principals has been involved in any self-regulatory organization proceedings that would be material to an evaluation of our firm's advisory business or the integrity of our firm's management.

## **7. Other Financial Industry Activities and Affiliations**

Neither our firm, nor any of our directors, officers or principals is registered as a broker-dealer or a representative of a broker-dealer or has an application pending to register as a broker-dealer or a registered representative of a broker-dealer.

### Relationships with Pooled Investment Vehicles

#### *Our Private Investment Funds*

Our firm and our affiliate, Keyframe Capital Advisors, L.L.C., sponsor several private investment funds that we manage. Our clients do not have independent management. Although this arrangement may give us heightened control and discretion over our clients, we manage any potential conflicts of interest by adhering to the investment strategy and investment allocation policy discussed in their private placement memoranda or other governing documents.

#### *Co-Investment Funds*

We may in the future, create and manage vehicles to facilitate co-investments by certain interested investors.

#### *Special Purpose Vehicles Wholly Owned by our Clients*

Our private funds may make investments through other private vehicles that our firm or a related adviser can manage. These private vehicles will not contain any investors other than our investment fund clients. Investing our clients' funds into another vehicle that we manage presents the potential opportunity for our firm to charge our clients fees at multiple levels. However, while our clients indirectly bear all investment and operating expenses, we do not charge these private vehicles any management or performance fees in connection with our management services and therefore our clients do not pay to us further management or performance fees in addition to those that we charge at the client level. In

addition, since we do not allow investors other than our clients or clients of our related investment advisers to invest in these private vehicles, these vehicles will not compete with our clients for investments.

## Relationships with Other Investment Advisers

### *Cyrus Capital Partners, L.P.*

We provide discretionary and non-discretionary advisory services to Cyrus Capital Partners, L.P. with respect to its advisory clients or certain positions in their portfolios. Cyrus Capital Partners, L.P. pays us a combination of fixed-fees with respect to certain positions, as well as a portion of asset-based management fees and performance fees that Cyrus Capital Partners, L.P. and/or its affiliates receive from its clients. In addition, under an infrastructure services agreement, Cyrus Capital Partners, L.P. provides certain administrative, execution and support services to our firm, as well as compliance and legal support, on a cost basis, unless our revenues exceed a certain threshold, in which case our firm will pay additional compensation to Cyrus Capital Partners, L.P. We share office space with Cyrus Capital Partners, L.P., and there are no “chinese wall” arrangements between our firm and Cyrus Capital Partners, L.P., which may cause our firm to become restricted in connection with certain material non-public information and investment activities conducted by Cyrus Capital Partners, L.P. Since our firm and Cyrus Capital Partners, L.P. are subject to a common compliance framework, including investment allocation policies, our firm is required to present investment opportunities to Cyrus Capital Partners, L.P. and its advisory clients, provided that no less than 50% of each such opportunity will be reserved for our fund clients. Mr. John Rapaport owns a minority interest in Cyrus Capital Partners, L.P. and its affiliates, and therefore receives compensation from Cyrus Capital Partners, L.P. aside from his revenues from the firm. This interest is not expected to represent a significant portion of Mr. Rapaport’s revenues.

### *TeraWatt Infrastructure, Inc.*

Certain of our clients have an investment in we hold a seat on the board of TeraWatt Infrastructure, Inc. (“TeraWatt”). TeraWatt receives a performance fee and management fee for various entities that it manages and our clients that invested in TeraWatt receive a net profit from these fees as a result of their equity ownership. Additionally, certain of our clients also have investments in these entities.

We do not recommend or select other investment advisers for our clients. We do not receive any additional compensation other our standard management fees, performance compensation and in certain instances, a fixed-fee in connection with such an arrangements.

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

As an investment adviser, our firm stands in a position of trust and confidence with respect to our clients—the investment funds we advise or sub-advise. Our firm has a fiduciary duty to place the interests of client funds before the interests of our firm and our firm’s employees. All of our personnel must put the interests of our clients before their own personal interests and must act honestly and fairly in dealings with our clients. All of our personnel must also comply with all federal and other applicable securities laws.

To promote our fiduciary duties and legal obligations, our Code of Ethics contains policies regarding gifts and entertainment, outside business activities and other conflicts of interest, political contributions (including the “pay-to-play” rule), personal trading and trading restrictions, reporting violations and disciplinary action. Although our personnel can provide entertainment in the course of interacting with current and prospective investors in our clients, any such entertainment will be reported to the Chief Compliance Officer in accordance with our Code of Ethics. We will provide a copy of our Code of Ethics to any client, or investor in a client, or prospective client or prospective investor upon request.

As part of our Code of Ethics, we have adopted a personal trading policy requiring all of our employees to disclose all holdings in personal accounts and all personal securities and derivatives transactions in a timely manner. In accordance with our Code of Ethics, our firm maintains a “Restricted List” that contains the names of companies of which we have determined to restrict trading activity by our personnel, typically because our clients hold, or we anticipate that they may hold, active positions in these companies or because one of our investment professionals is a member of the board of a public company. Generally, an employee may not, for his or her personal account, trade securities of an issuer included on the Restricted List (or any derivative thereon), though our Chief Compliance Officer or his designee may grant limited exceptions in certain circumstances after an employee seeks pre-approval. In fact, our Chief Compliance Officer or his designee must pre-approve all employees’ personal securities trades (including cryptocurrency transactions), subject to limited exceptions. Employees must also submit quarterly and annual reports disclosing all of their personal securities holdings, subject to limited exceptions.

We may occasionally, under exceptional circumstances, determine that it is in line with certain clients’ investment strategies and in the best interest of our clients to have one client purchase a security from another client of our firm or Cyrus Capital Partners, L.P. that is selling the same security, otherwise known as a “cross trade.” Cross trades may create conflicts of interest because they are not independently negotiated and may provide an opportunity for an investment adviser to collect related commissions. However, we do not take any commissions or fees in connection with effecting cross trades between our clients. In fact, we engage brokers to effect our clients’ cross trades, whose commissions are equally borne by both participating clients. Our Chief Investment Officer and our Chief



Compliance Officer must approve all cross trades before they are executed. In addition, our trading desk must notify our Chief Compliance Officer or his designee of any cross transactions, who must document the reason for the trade and the approval obtained.

Our personnel may invest their personal funds in our clients, including through our employee vehicle, and other unaffiliated private funds, and, therefore, they may hold the same securities as the investors in our clients. In addition, when they arrive at our firm, certain of our employees may already own securities in their personal accounts that we also recommend to our client funds. If our employees buy or sell these securities for their personal accounts, a conflict of interest may arise if our employees receive more favorable execution prices than do our clients because our employees' trades might have driven up the market prices of target securities. As described above and further in our Code of Ethics, we have established procedures designed to limit conflicts of interest in cases where our employees may buy or sell, for themselves, securities that we recommend to our clients.

Our Code of Ethics prohibits our employees from actively buying or selling securities for their own accounts that we are currently recommending that our clients buy or sell.

## **9. Brokerage Practices**

Our firm utilizes various brokers and dealers to execute, settle and clear securities transactions. In selecting broker-dealers and determining the reasonableness of their commissions for our clients' transactions, we consider the following factors, among others:

- a broker-dealer's quality of execution,
- a broker-dealer's ability to effect the transaction,
- a broker-dealer's trading expertise and volume,
- a broker-dealer's facilities,
- a broker-dealer's reliability,
- a broker-dealer's reputation, financial responsibility and stability,
- a broker-dealer's willingness and ability to commit capital,
- the nature and extent of a broker-dealer's customer service,
- a broker-dealer's general responsiveness,
- a broker-dealer's access to underwritten offerings and secondary markets,
- any research-related services and equipment provided by a broker-dealer, and

- the overall cost of a trade, including commissions.

If we determine, in good faith, that any commissions a broker charges or the prices a dealer charges are reasonable in relation to the value of services that we and our clients receive, our clients may pay commissions or prices that are greater than those another broker or dealer might charge.

In addition, we may accept certain operations-based consulting services in areas such as facilities management technology, design and build, real estate and third-party service providers from a broker-dealer that we do not pay for. These consulting services are designed to assist our firm in providing efficient investment management services for our clients and improving our dealings with third parties. Receiving these consulting services may give rise to a conflict of interest for our firm because we may be incentivized to use a particular broker-dealer or pay higher commissions or prices than those another broker or dealer might charge. We will only enter into this type of arrangement if we believe that the broker-dealer providing these services charges fair commissions in light of the overall value of services that our clients receive from the broker-dealer.

We Utilize Research and Other Soft Dollar Benefits. At times, our firm will likely pay higher prices to buy securities from, or accepts lower prices for the sale of securities to, brokerage firms that provide us with investment and research information and other services like those we describe immediately above. This investment and research information and the consulting services we describe above is sometimes referred to as one type of “soft dollar” benefit, and may also be referred to as “full-service brokerage.” The research services that broker-dealers typically provide us with include:

- written information and analyses concerning specific securities, companies or sectors,
- market, financial and economic studies and forecasts,
- news and research services,
- statistics and pricing or appraisal services,
- discussions with research personnel, and
- invitations to attend conferences or meetings with management or industry consultants.

We are authorized to use these products and services in connection with our advisory services for any of our accounts, not necessarily for only the account that “paid” for them. For example, we could utilize research services that a broker-dealer provides for one of our

funds in connection with our advisory services for other accounts and vice versa. We aim to allocate soft dollar benefits among our clients in a fair and equitable manner, but may not necessarily allocate soft dollar benefits to each of our client accounts in proportion to the commissions that each client generates.

We note that another type of soft dollar relationship exists, in which a broker-dealer awards an investment adviser with credits based on commissions generated by an investment adviser's client. Investment advisers can typically use these credits to buy certain products or services offered by a broker-dealer or to pay the expenses and costs of third parties that provide an investment adviser with benefits. We do not engage in this type of soft dollar relationship with any broker-dealer.

When We Use Soft Dollar Benefits, We Intend for our Use to Fall Within the Safe Harbor. The Securities and Exchange Commission has created a safe harbor that protects financial advisers from liability for a possible breach of fiduciary duty to their clients for engaging in soft dollar arrangements for certain research and execution services at other than the lowest transaction costs if they make a good faith determination that the amount of the commission was reasonable in relation to the value of the research or execution services received. We intend that any soft dollar benefits that we receive will fall within this safe harbor.

The Use of Soft Dollars Can Create a Conflict of Interest. Using client transactions to obtain research and other benefits creates incentives that result in conflicts of interest between advisers and their clients. If we use client markups or markdowns to obtain research products and other services, our firm receives a benefit because we do not have to produce or pay for the research products and other services. The availability of these benefits may influence us to select one broker-dealer rather than another to perform services for clients, based on our interest in receiving the products and services instead of on our clients' interest in receiving the best execution prices. Obtaining these benefits may cause our clients to pay higher fees than those charged by other broker-dealers.

Our use of soft dollar benefits in the form of research products and other services creates a conflict of interest between our firm and our clients because our clients pay for products and services that are not exclusively for their benefit and that may be primarily or exclusively for the benefit of our firm or other clients. To the extent that we acquire these products and services without expending our own resources, any use of soft dollar benefits may increase our profitability.

We do not have any procedures to direct client transactions to broker-dealers in return for soft dollar benefits.

### We Do Not Consider Referrals in Selecting or Recommending Broker-Dealers.

Our Clients Do Not Direct Brokerage. As all of our clients are private investment funds that we manage, we select all broker-dealers for our clients.

### Trade Aggregation and Allocation

Because our clients generally follow the same investment strategy, we tend to have multiple clients participating in the same investment opportunities. In addition, our firm is required to present and share investment opportunities with investment advisory clients of Cyrus Capital Partners, L.P. as described in Item 7 above. When determining whether or not a client should participate in an investment opportunity, we consider, with respect to each client:

- amount of cash available (whether within the fund already or committed that can be drawn down),
- current portfolio composition,
- any specific investment restrictions,
- the liquidity currently available in the marketplace, and
- the anticipated liquidity when unwinding the investment.

For each shared investment opportunity, we typically place one aggregate order on behalf of all participating clients, unless, under a particular circumstance, we believe that doing so would not be in the best interest of our clients or consistent with our best execution policy. We typically allocate aggregated orders among our participating clients' (advisory clients and fund clients) accounts *pro rata*, based on (1) their net asset values and available cash or, (2) uncalled capital commitments. We may, however, determine that a *pro rata* allocation is not appropriate in certain circumstances, such as when:

- certain clients are restricted from participating in certain initial public offerings;
- certain clients have cash limitations or limitations because of current portfolio holdings (for example, existing percentage holdings in an issuer or specific industry type);
- certain clients are restricted or may face adverse consequences from participating in an investment due to tax, legal or regulatory considerations;

- an order has only been partially filled and contains so few shares that a *pro rata* allocation would be impracticable or result in a nonconforming allocation for one or more clients;
- we are seeking to level positions across clients (due to, for example, new capital commitments, capital infusions or withdrawals);
- we are “ramping up” a newly launched client vehicle;
- we are effecting hedging transactions, follow-on investments, re-securitization transactions and similar investments, which generally will be allocated *pro rata* in accordance with the holdings of each client of the underlying investment to which the hedging transaction, follow-on investment or re-securitization transaction relates, subject to certain exceptions;
- we are seeking to align European investment exposure for certain clients; and/or
- client mandates require that we allocate an order otherwise.

Allocations to a client are subject to the terms and limitations set forth in the private placement memorandum and/or governing documents of each client. Because at times we make non-*pro rata* allocations, two or more clients with similar or overlapping investment programs may produce results that are materially different from each other.

Although we generally effect sales of investments that multiple clients hold on a *pari passu* basis, at times we sell investments from various clients on a non-*pro rata* basis based on a wide variety of factors, including those we describe above relating to the non-*pro rata* allocation of investment opportunities. Accordingly, it is possible that one client may be selling an investment, while another client is retaining or investing more capital in the same investment.

If we do not allocate a trade in accordance with the guidelines set forth in our policy above, the responsible analyst must first receive pre-approval from our Chief Investment Officer and logged by our Chief Compliance Officer.

We can average prices paid for certain aggregated transactions. Clients can ultimately benefit when we aggregate trades because each client gets volume discounts on execution costs, and may otherwise be unable to execute an investment decision as effectively as it could have had it acted alone, or alternatively, pay a higher price as a result of aggregation..

We will provide a copy of our complete order aggregation and trade allocation procedures policy to any client, or investor in a client, or prospective client or prospective investor upon request.

### General Conflicts of Interest

We have a policy in place pursuant to our compliance manual to ensure that our employees report actual or potential conflicts of interest between us and our clients to the general counsel or the chief compliance officer. The general counsel or chief compliance officer will discuss the actual or potential conflict of interest with the reporting employee and following such discussion, the general counsel or chief compliance officer will discuss the matter with the firm's executive officers and outside counsel as appropriate to determine a course of action.

## **10. Review of Accounts**

John Rapaport, our Chief Investment Officer, and our analysts are aware of the holdings in each client's account on a continuous basis. Mr. Rapaport and our analysts monitor these holdings in light of trading activity, significant corporate developments and other activities which may dictate a change in portfolio positions. Mr. Rapaport and our analysts review client accounts periodically from the standpoint of the specific investment objectives of each client and as particular situations may require.

In addition, on a periodic basis, Mr. Rapaport reviews our clients' holdings against various risk parameters.

Those positions with a price movement of greater than 3% are subject to heightened scrutiny by Mr. Rapaport and our analysts. In addition, before deciding whether to purchase or sell a particular security on behalf of any of our fund clients, Mr. Rapaport and our analysts review, in full, each client account that holds, or is about to hold, the security.

Investors in all of our fund clients receive written quarterly update letters that contain performance information for the applicable fund and audited written annual reports. In addition, investors (and their ultimate beneficiaries) may also receive unaudited written monthly reports of the performance of the client fund in which they have invested.

## **11. Client Referrals and Other Compensation**

Our firm does not, nor do any principals or employees of our firm, receive any economic benefit from non-clients for providing advisory services to our clients.

Employees may serve on the boards of directors of companies in which our clients invest (including a public company's board of directors) and may, under certain circumstances, receive compensation or other benefits from the companies in connection with these roles. In most cases, compensation in the form of cash or equity that an employee earns from serving as our firm's representative on the board of a company in which our clients invest is remitted to the relevant clients by offsetting any amounts they owe our firm for expenses

we have incurred on their behalf. However, employees serving as our firm's representative on the board of directors of a portfolio company also, at times, receive certain non-equity and non-cash benefits that they retain (for example, unlimited complimentary flights and other travel accommodations). We will place any company for which an employee serves on its board of directors on our firm's "Restricted List" and only permit trading in that company's securities by our clients and our employees during permitted time windows. We also have specific policies and procedures in place to monitor when an employee serves on the board of a public company and also to monitor any trading by our client or employee in such company during such permitted time windows.

## **12. Custody**

While it is our firm's general practice not to accept or maintain physical possession of any of our clients' assets, we generally are deemed to have custody of our fund clients' assets under Rule 206(4)-2 of the Investment Advisers Act of 1940, as amended, because we have the authority to deduct fees and expenses from our fund clients' accounts.

In order to comply with Rule 206(4)-2, we utilize the services of qualified custodians (as defined under Rule 206(4)-2) to hold all assets of our fund clients, or seek to ensure that all our clients have engaged a qualified custodian to hold all assets that we manage and over which we are deemed to have custody. We also ensure that each qualified custodian maintains these funds in accounts that contain only clients' funds and securities. In accordance with Rule 206(4)-2, we also (1) engage an outside auditor to audit our fund clients at the end of each client's fiscal year and (2) distribute the results of the audit in audited financial statements that are prepared in accordance with generally accepted accounting principles to all investors in our fund clients within 120 days after the end of each client's fiscal year. We also receive quarterly account statements on behalf of our fund clients, which we compare with our own records.

## **13. Investment Discretion**

### Scope of Authority

For our fund clients, our firm accepts discretionary authority to manage their assets. Essentially, this means that we have the authority to determine, without obtaining specific client consent, which securities to buy or sell and the amount of securities to buy or sell. Despite this broad authority, we are committed to adhering to the investment strategy and program set forth in each of our clients' private placement memoranda or other governing documents. With respect to our non-discretionary advisory services, we provide investment recommendations which Cyrus Capital Partners, L.P. may then delegate us to implement.

### Procedures for Assuming Authority

Before accepting their subscriptions for interests, we provide all investors in our clients with a private placement memorandum and/or governing documents that set forth, in detail, our investment strategy and program and the terms of investment for investors. By completing our subscription documents to acquire an interest in one of our client funds or otherwise becoming a signatory to the operating agreements of our client funds, investors give us complete authority to manage their investments in accordance with the private placement memorandum and/or governing documents they each received.

In addition, under investment management agreements with each client fund, our clients have granted our firm full power of attorney over their assets, which gives us the right to pursue their investment programs at our full discretion and all rights, privileges and powers of ownership with respect to their assets.

### **14. Voting Client Securities**

Our firm has authority to vote our clients' securities. Our policy is to vote proxies solely in the best interests of our clients. Generally, we believe that a company's management is best suited to make decisions that are essential to the ongoing operation of the company. Therefore, we generally vote proxies in line with a company's management. However, under certain circumstances, when we believe that management's proposal is not designed to maximize value for our clients, we will vote against management.

Clients, and investors in our clients, cannot direct our portfolio managers' proxy votes.

If there are any potential conflicts of interest in connection with voting a client proxy, our Chief Compliance Officer must present any purported conflict to our Chief Investment Officer. Our Chief Compliance Officer must document the matter thoroughly and preserve the documentation in accordance with our books and records policies.

Clients, or investors in our clients, may obtain information about how we voted proxies and/or a copy of our proxy voting policies by contacting our Investor Relations Team at the telephone number on the cover of this brochure.

### **15. Financial Information**

We do not require nor do we solicit prepayment of more than \$1,200 in fees per client, six months or more in advance.

We are not aware of any financial condition that is likely to impair our ability to meet our contractual commitments to our clients.

Our firm has never been the subject of a bankruptcy petition.