IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

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| In re: | ) | Chapter 11 |
| HIGHLAND CAPITAL MANAGEMENT, L.P.,[1] | ) | Case No. 19-12239 (CSS) |
| Debtor. | ) | |

**Objection Deadline: November 12, 2019 at 4:00 p.m. (ET)**
**Hearing Date: November 19, 2019 at 12:00 p.m. (ET)**

**PRECAUTIONARY MOTION OF THE DEBTOR FOR ORDER APPROVING PROTOCOLS FOR THE DEBTOR TO IMPLEMENT CERTAIN TRANSACTIONS IN THE ORDINARY COURSE OF BUSINESS**

The above-captioned debtor and debtor in possession (the "Debtor") files this precautionary motion (the "Motion") for the entry of an order approving protocols for the Debtor to implement certain transactions in the ordinary course of business. In support of this Motion, the Debtor respectfully represents as follows:

**Jurisdiction and Venue**

1. The United States Bankruptcy Court for the District of Delaware (the "Court") has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the *Amended Standing Order of Reference from the United States District Court for the District of Delaware*, dated February 29, 2012. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2), and the Debtor confirms its consent pursuant to Rule 9013-1(f) of the Local Rules of Bankruptcy Practice and Procedure of the United States Bankruptcy Court for the District of Delaware (the "Local Rules") to the entry of a final order by the Court in connection

[1] The Debtor's last four digits of its taxpayer identification number are (6725). The headquarters and service address for the above-captioned Debtor is 300 Crescent Court, Suite 700, Dallas, TX 75201.

with this Motion to the extent that it is later determined that the Court, absent consent of the parties, cannot enter final orders or judgments in connection herewith consistent with Article III of the United States Constitution.

2. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

3. The statutory bases for the relief requested herein are sections 105(a), 363(c)(1), and 363(b) of the Bankruptcy Code.

**Background**

4. On October 16, 2019 (the "Petition Date"), the Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtor has continued in the possession of its property and has continued to operate and manage its business as a debtor in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee, examiner, or committee has been appointed in this chapter 11 case.

5. The Debtor is a multibillion-dollar global alternative investment manager founded in 1993 by James Dondero and Mark Okada. Highland operates a diverse investment platform, serving both institutional and retail investors worldwide. In addition to high-yield credit, Highland's investment capabilities include public equities, real estate, private equity and special situations, structured credit, and sector- and region-specific verticals built around specialized teams. Additionally, Highland provides shared services to its affiliated registered investment advisors.

6. To assist and coordinate the restructuring process, the Debtor retained Bradley D. Sharp as Chief Restructuring Officer of the Debtor (the "CRO") on October 7, 2019.

7. A more detailed description of the business and operations of the Debtor, and the events leading to the commencement of this chapter 11 case, is provided in the *Declaration of Frank Waterhouse in Support of First Day Motions*, filed on the Petition Date [Docket No. 9] (the "First Day Declaration") and incorporated herein by reference.[2]

## Overview of Ordinary Course Transactions

### I. The Ordinary Course Services

8. The Debtor generates revenue through the operation of three business lines: (i) proprietary trading; (ii) investment management; and (iii) the provision of middle and back office services (collectively, the "Ordinary Course Services").[3] The fees generated from the Ordinary Course Services are the Debtor's primary source of income and are necessary for the Debtor's successful reorganization. Although the Debtor believes that it has the authority to continue operating its business in the ordinary course without Court approval, the Debtor is filing this Motion and requesting approval of the Protocols (as defined herein) out of an abundance of caution. The approval of the Protocols will allow the Debtor to continue providing the Ordinary Course Services without seeking prior approval from this Court. If the Debtor were required to seek Court approval prior to buying or selling assets in every instance, the Debtor's ability to

[2] Capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the First Day Declaration.

[3] As a registered investment adviser, the Debtor files a Form ADV with the Securities and Exchange Commission no less than annually. The Form ADV is in two parts. The second part – the Form ADV-2A – requires the Debtor to publicly disclose the types of advisory services it offers and its methods of analysis and investment strategies, among other things. The Debtor's Form ADV-2A (the "Form ADV-2A") discloses to the Debtor's clients and the public generally that the Debtor will provide the Ordinary Course Services described in this Motion. A copy of the Form ADV-2A is attached hereto as **Appendix I**. The Form ADV-2A is publicly available at: https://www.adviserinfo.sec.gov/Firm/110126. The Form ADV-2A was last updated on October 16, 2019, to disclose the Debtor's bankruptcy filing. It was not otherwise updated.

generate positive returns for its clients and creditors in this fast moving marketplace will be severely compromised.

A. Proprietary Trading

9. **Proprietary Accounts.** The Debtor, in the ordinary course of its business, buys and sells assets for its own account through its prime brokerage account at Jefferies, LLC (the "Prime Account")[4] and through a non-Debtor entity, Highland Select Fund, L.P. (the "Select Fund"[5] and together with the Prime Account, the "Proprietary Accounts").[6] As of the Petition Date, the Debtor held approximately $87 million in liquid and illiquid securities in the Prime Account. The Select Fund held approximately $138 million in securities,[7] excluding private equity holdings. The Debtor will not trade in the Prime Account or distribute any cash or assets from the Prime Account without the consent of Jefferies, LLC.

10. In the ordinary course of the Debtor's business, the Debtor, in its sole and absolute discretion, would buy and sell assets directly through the Prime Account and indirectly through the Select Fund. These trades would be either opportunistic or done to generate liquidity

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[4] As described in the First Day Declaration, as of the Petition Date, the Debtor had borrowed approximately $30 million on margin from Jefferies, LLC, which is secured by the securities held in the Prime Account. The Debtor does not intend to borrow any additional amounts on margin without the Court's prior approval.

[5] The Select Fund is a Delaware limited partnership. The Debtor owns directly and indirectly 99.95% of the Select Fund's limited partnership interests. The balance of such interests, 0.05%, are held directly or indirectly by insiders of the Debtor, including James Dondero. The Select Fund is managed by its general partner, Highland Select Equity Fund GP, L.P., a Delaware limited partnership (the "Select Fund GP"). The Select Fund GP is directly and indirectly wholly-owned by the Debtor. The Debtor, through the Select Fund GP, can cause the Select Fund to buy and sell assets in its sole discretion. The Debtor obtains cash from the Select Fund by submitting a redemption request consistent with the Select Fund's governing documents.

[6] The Debtor requested authority to liquidate securities held in the Prime Account to fund its operations during its bankruptcy through the *Motion of Debtors for Entry of Interim and Final Orders (A) Authorizing the Use of Cash Collateral, (B) Providing Adequate Protection, (C) Authorizing the Liquidation of Securities, (D) Modifying the Automatic Stay, and (E) Scheduling a Final Hearing* (the "Cash Collateral Motion"). The Debtor withdrew the Cash Collateral Motion on October 29, 2019.

[7] The $138 million in securities equates to $171 million in market value of long positions netted against $33 million in market value of short positions.

to fund the Debtor's day-to-day business operations. The Debtor's ability to exercise its discretion over such transactions – and to make decisions in real time – in accordance with the Protocols is necessary to effectively generate returns from these accounts.

11. The value of the securities the Debtor trades moves up and down on a daily basis if not minute to minute. In order to capture the value of those securities, the Debtor must be able to exercise its discretion and to effectuate sales or purchases in real time. If the Debtor is unable to do so, it may lose out on the ability to generate positive returns or may end up holding an asset that loses substantial value. In either case, the ability of the Debtor to generate value for its estate and its creditors would be severely compromised.

12. **Petrocap Interests.** In the ordinary course of its business, the Debtor, from time to time, directly invests in companies or investment partnerships managed by third parties. Currently, the Debtor is invested as a limited partner in Petrocap Partners II, L.P., ("Petrocap II") and Petrocap Partners III, L.P. ("Petrocap III," and together with Petrocap II, the "Petrocap Entities"). In order to become a limited partner in the Petrocap Entities, the Debtor committed to limited partnership interests in Petrocap II in 2015 and in Petrocap III in 2018 (collectively, the "Petrocap Interests").

13. The Debtor made a capital commitment to Petrocap II of $18.7 million and to Petrocap III of $15 million. Pursuant to the limited partnership agreements governing, the Petrocap Entities and the Debtor's Petrocap Interests the general partner of the respective Petrocap Entity can call capital from its limited partners up to the amount of such limited partner's capital commitment when capital is needed, for example, to consummate a transaction or fund an expense. Capital is generally called on a quarterly basis. If a capital call is made, the

Petrocap Entities' limited partners are generally required to fund the portion of their capital commitment called within ten days. If a limited partner fails to fund a capital call, it would be in default of its obligations to the respective Petrocap Entity and could be subject to certain punitive measures, including being charged interest or being forced to sell its Petrocap Interests.

14. As of the Petition Date, the Debtor had $7.2 million in remaining unfunded capital commitments to Petrocap II and $14.2 million to Petrocap III.[8] The Debtor has no control over when or if either of Petrocap II or Petrocap III call capital or discretion with respect to how such capital is used; however, neither Petrocap Entity can call capital from the Debtor in excess of its remaining capital commitment.

15. The Petrocap Entities generally invest in oil and gas. The Debtor believes its Petrocap Interests represent strong investments and have the potential to return substantial capital to the Debtor and its estate. However, if the Debtor is unable to fund a capital call in the ordinary course or is required to seek approval from this Court before funding, the Debtor risks failing to make the capital call within the allotted time, if at all. If the Debtor fails to fund capital when due, it risks the loss of the Petrocap Interests and the substantial potential gains represented by such interests.

16. As such, the approval of the Protocols would allow the Debtor to continue trading through its Proprietary Accounts and satisfying its obligations with respect to the Petrocap Interests while providing transparency to the parties in interest in this case.

[8] The foregoing amounts are calculated based on capital statements provided by the Petrocap Entities to their limited partners on June 30, 2019.

**B. Investment Management**

17. As a registered investment advisor, the Debtor provides investment management services (the "Investment Services") to hedge funds, private equity style funds, separately managed accounts, and collateralized loan obligations pursuant to the terms of various contracts as discussed below (collectively, the "Clients").[9]

18. **Hedge Funds.** Hedge funds are a type of pooled investment vehicle, typically structured as a limited partnership, in which third-party investors subscribe for interests. The management of the fund is delegated to the fund's general partner and an investment manager retained pursuant to an investment management agreement. The investment manager is generally paid a management fee based on the value of individual limited partners' capital accounts and an incentive fee based on achieving outsized investment returns. Unlike other types of investment funds, investors in a hedge fund can redeem their interests in the fund. While redemptions occur in the ordinary course for all hedge funds, a hedge fund may need to sell assets to fund the redemption, which depending on the market, could result in an immediate loss if the sale price is low as well as a future loss of potential upside. Further, because an investment manager's fees are based on the amount of assets under management, redemptions will decrease such fees.

[9] The Debtor is invested as a limited partner in certain of its Clients. In those circumstances, the Debtor has the same economic interest and rights as the other limited partners in the Clients, and the Debtor's interest in such Client – and its ability to buy and sell such interests – is governed by the Debtor's internal policies and procedures, the individual agreements governing the Client, and applicable requirements set by the Securities and Exchange Commission.

19. Currently, the Debtor manages four hedge funds, and these hedge funds, in the aggregate, have approximately $286 million in net assets.[10] The Debtor manages these funds pursuant to the terms of various investment management agreements. Under these agreements, the Debtor has the sole discretion, subject to certain general investment restrictions, over the assets purchased or sold by its hedge funds Clients and the management and restructuring of such assets, which may include portfolio companies. The Debtor is paid a quarterly management fee from each hedge fund, which ranges from 0.00% to 1.50% of the value of the respective hedge fund's net assets. If the hedge funds do well, the Debtor may also receive a performance fee. Each of the Debtor's hedge fund Clients allows investors to redeem their capital subject to certain limited restrictions.[11]

20. **Private Equity Style Fund.** Private equity style funds are also pooled investment vehicles and generally structured as limited partnerships managed by the fund's general partner and an investment manager pursuant to an investment management agreement. The investment manager is generally paid a management fee based on the cost of the fund's investments or committed capital and an incentive fee. Unlike a hedge fund, however, private equity funds generally have "locked up capital," which means that investors cannot withdraw their invested capital. Private equity style funds are also for a limited duration, i.e., they are required to wind down and return capital to investors after a set number of years. Private equity

[10] Of these funds, only three pay fees to the Debtor. The fee-paying hedge funds had fee-earning assets under management of approximately $79 million as of September 30, 2019. One of those funds has received substantial redemptions in advance of and since the Petition Date, and, consequently, the Debtor and the CRO are reviewing whether to liquidate such fund.

[11] The Debtor's hedge fund Clients have "gates," which allow the hedge fund, at the Debtor's direction, to suspend investors' right to redeem their interests subject to certain restrictions. Although the Debtor may stop redemptions, it is generally a last resort as it can galvanize investor redemptions over the long-term and signal weakness to the marketplace.

funds also generally only pay incentive fees to their investment managers from realized gains whereas hedge fund managers may receive fees based on unrealized gains.[12]

21. The Debtor currently manages only two private equity fund pursuant to investment management agreements. The Debtor has the authority to direct the funds' purchases and sales of assets and the management and restructuring of such assets, including portfolio companies. However, the Debtor does not receive fees for managing the funds.[13] As of September 30, 2019, the private equity funds had net assets of approximately $303 million.

22. **Separately Managed Accounts.** A separately managed account (a "SMA") is a type of investment vehicle; however, unlike hedge funds or private equity funds, a SMA generally has only one investor. The SMA's management is delegated to an investment manager pursuant to an investment management agreement. The investment manager receives a management fee based on the net value of the SMA's assets and may also receive an incentive fee. An investor in a SMA can redeem its capital at any time.

23. The Debtor currently manages five SMAs pursuant to investment management agreements and receives fees from each of these SMAs. The two most material SMAs are an SMA for NexBank, SSB[14] (the "NexBank SMA"), and an SMA for the Charitable

[12] Although private equity style funds may purchase and manage underlying portfolio companies, they are not required to and instead may buy and sell liquid and illiquid securities and engage in investment strategies similar to a hedge fund. The defining characteristic of a private equity style fund is its locked-up capital structure and the payment of incentive fees only from realized gains.

[13] The Debtor is eligible to receive an incentive fee from both private equity fund, but the Debtor does not anticipate earning such fees in the future.

[14] As disclosed in that certain Motion of Debtor for Interim and Final Orders Authorizing (A) Continuance of Existing Cash Management System and Brokerage Relationships, (B) Continued Use of the Prime Account, (C) Limited Waiver of Section 345(b) Deposit and Investment Requirements, and (D) Granting Related Relief [Docket No. 5] (the "Cash Management Motion"), NexBank, SSB is indirectly owned by James Dondero and Mark Okada. Mr. Dondero is an insider of the Debtor and the owner of 100% of the equity in the Debtor's general partner, Strand Advisors, Inc. Mr. Dondero also has an indirect interest in the Debtor's Class A Limited Partnership interests. Mr. Okada is an insider of the Debtor and has an interest in the Debtor's Class A Limited Partnership interest.

DAF Fund, L.P.[15] (the "DAF SMA"). As of September 30, 2019, the NexBank SMA had fee-earning assets under management of approximately $913 million consisting primarily of a portfolio of loans that are actively managed by the Debtor. The Debtor has discretion, subject to certain general investment limitations, with respect to the investments made by NexBank SMA, including the ability to work out or restructure such assets. As of September 30, 2019, the DAF SMA had fee-earning assets under management of $225 million consisting of various liquid and illiquid securities. The Debtor manages the DAF SMA on a non-discretionary basis, meaning the Debtor recommends trades to DAF's trustee who then determines whether the DAF SMA will consummate the trade.

24. The Debtor is paid an annual management fee from each of NexBank SMA and DAF SMA equal to 0.30% to 2.00% of the respective SMA's applicable asset base and, with respect to the DAF SMA, the Debtor receives an incentive fee of up to 20% of net capital appreciation during a calculation period.

25. **Collateralized Loan Obligations.** A collateralized loan obligation (a "CLO") is a type of structured product. A CLO is generally a Cayman-domiciled entity which acquires a pool of loans. The loans held by the CLO vary in size, maturity, interest rate, geography, and loan priority. In connection with its acquisition of loans, a CLO issues notes to third party investors. The notes are issued in various tranches with each tranche having a different interest rate and different priority of payment. The notes are secured by the CLO's loans and are generally nonrecourse to the CLO. A CLO pays the amounts due on the notes

[15] The Charitable DAF Fund ("DAF"), a donor advised fund, is a non-profit that donates to various charities focusing on healthcare, children's education, and veteran affairs as well as museums, zoos, and other public arts. DAF originally was seeded with a corpus of assets donated by the Debtor in 2011.

from the interest and principal payments on its portfolio of loans pursuant to a payment waterfall contained in the indenture governing the CLO. A CLO will also generally have one tranche of equity, also called subordinated notes, which receives the CLO's available residual cash flow each quarter after the CLO has made its quarterly note payments.

26. The CLO itself is a passive vehicle that has a board of directors but no active employees or management. Instead, the CLO contracts with a third-party collateral manager to manage its portfolio of loans.[16] The CLO generally has an investment period during which the collateral manager may acquire new loans for the CLO; however, that period typically lasts no more than several years from the date the CLO was created. The collateral manager will generally have authority to work out problem loans and to sell loans throughout the life of the CLO. The collateral manager is typically paid a management fee based on the principal balance of the loan portfolio and a performance fee provided that certain metrics are achieved.

27. The Debtor currently is the collateral manager for twenty CLOs[17] pursuant to certain servicing agreements.[18] Of these CLOs, eighteen are fee-earning. The Debtor may, in its sole discretion, sell loans from the CLOs' portfolios or work out or restructure any loans;[19] however, the CLO Clients are no longer permitted to acquire new loans and the CLOs are no longer raising capital. The Debtor is entitled to an annual management fee (comprised of a senior fee and a subordinated fee) from each CLO ranging from 0.15% to 0.55% based on the

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[16] The holders of the CLO's notes may in certain circumstances have consent or other rights that can be exercised by all or a portion of the notes following an event of default. Such rights, however, are generally limited.

[17] The Debtor also serves as a sub-advisor for one CLO.

[18] Certain of the Debtor's affiliates and related parties may invest in the CLO Clients from time to time.

[19] The documents governing the Debtor's CLO Clients allow holders of the most senior tranche of notes in certain instances to direct the Debtor, as collateral manager, for certain enumerated actions. The Debtor does not believe that those provisions will materially impact its ability to manage the CLO's loan portfolio in its sole discretion.

principal balance of the CLOs' loans as well as an incentive fee. However, if a CLO's loan portfolio fails certain collateralization tests, the subordinated fees are deferred until the CLO is able to pass such tests, and if cash sufficient proceeds are not generated, any such deferred fees will not be paid until sufficient cash exists. Currently, the Debtor only expects to receive fees from 16 of its CLO Clients. The Debtor also does not anticipate that any CLO will pay incentive fees.

28. **Continuation in the Ordinary Course.** Because of the nature of the Investment Services, the continued provision of the Investment Services in the manner in which they were provided prepetition is paramount to the Debtor's ability to continue as a going concern and to generate revenue with which to fund its business and pay its creditors.

29. Like the Debtor's Proprietary Accounts, the value of the securities traded on behalf of the Debtor's hedge fund, private equity fund, SMA, and CLO Clients is volatile, and the ability to monitor and transact in assets opportunistically is what generates revenue for such Clients. If the Debtor is not able to exercise its discretion to direct the purchase and sale of securities or other assets (or to restructure such assets if required), it may lose substantial revenue. Further, the Debtor's CLO Clients and the NexBank SMA rely on the Debtor to opportunistically sell loans when possible and to work out and restructure troubled loans when required. If the Debtor's ability to provide those services is compromised, the Debtor's Clients, and consequently the Debtor, could fail to realize the true value of their assets.

30. Finally, if the Debtor fails to provide the Investment Services to its Clients in the manner it provided prepetition, the Debtor could be in postpetition breach of its various investment management and services agreements, not to mention its fiduciary obligations to its

Clients. Such a breach may provide Clients both the right to terminate such agreements and potentially causes of action against the Debtor. This would substantially impact the Debtor's cash flows and ability to reorganize.

31. Consequently, approving the Debtor's continued provision of the Investment Services, subject to the Protocols, would allow the Debtor to provide the Investment Services to its Clients and also provide comfort to the parties in interest in this case that the Investment Services were being provided in a transparent manner.

**C. Shared Services**

32. Pursuant to various agreements, the Debtor's employees provide middle and back office services and investment support to other entities (the "Shared Services"). These Shared Services include, among other things, providing investment research, assisting with legal and compliance issues, providing tax advice, helping to value investments, and marketing support. In consideration for the Shared Services, the Debtor receives aggregate fees from its counterparties in excess of $1 million per month. The Debtor uses those fees, in part, to pay its employees.

33. While the Debtor believes that its continued provision of the Shared Services in the ordinary course is non-controversial, if the Debtor could no longer provide the Shared Services in the manner provided prepetition, it would lose the fees that come with it, which represent approximately half of the Debtor's monthly revenue, excluding potential incentive fees.

34. Approving the Protocols would ensure continued transparency with respect to the provision of the Shared Services. However, the provision of the Shared Services do not include the purchase or sale of any asset or security.

## II. The Ordinary Course Trades

35. As disclosed in the First Day Declaration, on and following the Petition Date, to generate liquidity, a portion of which was used to fund operations and certain projected chapter 11 administrative expenses, the Debtor liquidated certain securities held in the Select Fund in the ordinary course of business (the "Ordinary Course Trades"). With respect to such trades, the Debtor followed the following protocol as disclosed in the First Day Declaration: (i) all trades were with unaffiliated third parties; (ii) all securities were traded through either a public or over-the-counter exchange; and (iii) all trades were fully disclosed to the CRO. The date and amount of each Ordinary Course Trade is set forth on **Appendix II** hereto. The Ordinary Course Trades are consistent with the Debtor's purchase or sale of securities in the Select Fund as disclosed above and with the Protocols.

36. As discussed above, subject to the Protocols, the Debtor contemplates buying and selling assets through the Select Fund and the Prime Account (with the consent of Jefferies, LLC).

## III. Street Name Change

37. As disclosed in the First Day Declaration, the Debtor, in the ordinary course of business, may be the named counterparty with various broker dealers through which the Debtor trades securities on behalf of its Clients. Any transactions that the Debtor executes on behalf of its Clients are settled through non-Debtor Client accounts pursuant to a standardized

internal allocation system. As such, the Debtor has no economic or property interest in any such assets, nor is the Debtor likely to have any liability if any trade fails.[20]

38. Following the Petition Date, certain dealers suggested that the Debtor should no longer be the named counterparty now that the Debtor is in bankruptcy and, instead, that a non-Debtor entity act as the "street name" on the trades. In response to this request, the Debtor is in the process of changing the name through which it interfaces with its broker dealers on behalf of its Clients (as defined herein) from the Debtor's own name to the name of an affiliate designee (the "Street Name Change"). The Street Name Change does not change the nature of the Debtor's relationship with the broker dealers with whom the Debtor interacts. The Debtor will continue to enter into transactions with such broker dealers on behalf of its Clients, just in the name of an affiliate designee, and any such transactions are settled directly in the Debtor's Client's accounts pursuant to a standardized internal allocation system. The Debtor's proposed Street Name Change is for nominal purposes only and will not affect any substantive rights of the Debtor or anyone else.

## IV. Intercompany Transactions.

39. **Cash Management Transactions.** As disclosed in the Cash Management Motion, the Debtor occasionally engages in intercompany cash transactions with certain of its affiliates. The transactions disclosed in the Cash Management Motion included the following (collectively, the "Cash Management Transactions"):

[20] Under the Debtor's internal policies and procedures, liability for payment on unsettled trades rests solely with the managed fund on whose behalf the trade was executed.

a. Highland Multi Strategy Credit Fund, L.P. The Debtor serves as the investment manager for Highland Multi Strategy Credit Fund, L.P. ("MSCF") and is also a limited partner in MCSF. MCSF invests in and holds certain life settlement policies that require regular payment of premiums (generally monthly) to keep the policies from lapsing. If the policies were to lapse, MCSF would be unable to collect when the proceeds of such policies become realizable and, consequently, its ability to make distributions to the Debtor as a limited partner or pay amounts owed to the Debtor as the investment manager would be impaired. Because MSCF has limited liquidity, the Debtor provides MSCF the funding required to pay the premiums on its life settlement policies, among other expenses, in the amount of approximately $1 million per month. In return, MSCF issues on demand, zero interest notes to the Debtor, which will be repaid once MSCF's investments become liquid. Although the Debtor made the following representations about MSCF in the Cash Management Motion, in the interest of transparency, the Debtor wishes to supplement that record as follows:

- At the hearing held on October 18, 2019 (the "First Day Hearing"), the Debtor's first day declarant, Frank Waterhouse, testified that the Debtor held a greater than 51% interest in MSCF. However, the Debtor only directly or indirectly holds a 35% interest in MSCF as of September 30, 2019.
- Further, consistent with Mr. Waterhouse's testimony at the First Day Hearing, the assets held by MSCF consist of a large allocation of life settlement policies, which as of the Petition Date represented approximately 20% of the fair market value of MSCF's assets.[21] MSCF also holds loans and equity securities, which represent the remainder of the gross investments as of the month-end preceding the Petition Date.
- The Debtor expects to lend MSCF approximately $1 million per month to fund its operations absent liquidity at MSCF.[22] As disclosed in the Cash Management Motion, such amounts are used to pay the life settlement premiums owed by MSCF and certain expenses. Specifically, approximately 62% of such amount is used to pay life settlement premiums, 12% is used to

[21] The notional value of the life settlement policies exceeds the net asset value of all other net assets of MSCF.

[22] Subsequent to the Petition Date, MSCF received a pay down from one of its portfolio investments. This amount will provide temporary liquidity to MSCF and, accordingly, reduce the future amounts that will need to be borrowed from the Debtor.

fund general operating expenses, and 26% is used to pay principal and interest on a term loan in the current principal amount of approximately $33 million owed to NexBank, SSB.[23] The amounts owed to NexBank, SSB are secured by certain of MSCF's assets, which were valued at approximately $67 million as of the Petition Date.

b. Highland Capital Management Korea Limited. Highland Capital Management Korea Limited ("HCM Korea") is a wholly-owned subsidiary of the Debtor and an affiliated investment advisor domiciled in South Korea. HCM Korea is the advisor for, and minority limited partner in, an investment fund (the "HCM Korea Fund"). Each limited partner in the HCM Korea Fund, including HCM Korea, is required to provide capital when called by the HCM Korea Fund, and the failure to fund capital calls could lead to a default under the HCM Korea Fund's partnership agreement. Because of HCM Korea's limited liquidity, the Debtor has provided HCM Korea with a revolving note pursuant to which the Debtor has extended up to $20 million in credit for HCM Korea to use to fund its commitments to the HCM Korea Fund. The note is at zero percent interest, and there is currently approximately $3.06 million outstanding on the note. The Debtor anticipates that HCM Korea will draw an additional $3 million on the note over the next one to two years and will repay the note as the HCM Korea Fund realizes gains on its portfolio and distributes those gains to its investors.

c. Highland Capital Management Latin America, L.P. Highland Capital Management Latin America, L.P. ("HCM Latin America") is a wholly owned subsidiary of the Debtor and an affiliated investment advisor domiciled in the Cayman Islands. HCM Latin America is the advisor for an investment fund investing primarily in Argentina (the "SA Fund"). HCM Latin America employs several consultants to assist in advising and marketing the SA

[23] As disclosed in note 14, *supra*, NexBank, SSB, is indirectly owned by James Dondero and Mark Okada. Mr. Dondero and Mr. Okada are insiders of the Debtor.

Fund. However, because of the recent instability in the Argentinian market, the value of the SA Fund dropped precipitously and consequently, the SA Fund does not currently generate sufficient fees to cover the cost of these consultants. In addition to its original equity contribution, the Debtor has been contributing equity to HCM Latin America to help cover its costs during the downturn. To date, the Debtor has provided approximately $0.7 million in additional equity to cover such operating costs. As of the Petition Date, the Debtor anticipated that HCM Latin America would require additional equity contributions of between $1 million to $1.5 million per year until the Argentinian market recovers. Since the Petition Date, however, there have been sizeable investor redemptions from HCM Latin America. The Debtor and the CRO are monitoring the situation, but it is possible that HCM Latin American will be wound down.

d. Highland Capital Management (Singapore) Pte Ltd. Highland Capital Management (Singapore) Pte Ltd. is a wholly owned subsidiary of the Debtor based in Singapore ("HCM Singapore"). Historically, HCM Singapore has been a marketing office that has solicited investments in the Debtor's managed funds from Asian-based institutional investors. To facilitate HCM Singapore's marketing efforts, the Debtor agreed to cover HCM Singapore's costs. The Debtor agreed to this arrangement as any capital raised by HCM Singapore would directly increase the management fees – and potentially long-term incentive fees – earned by the Debtor. The Debtor believes such increased revenue, should it materialize, would more than offset the costs paid by the Debtor.

e. Expense Allocations. As is customary among investment advisors, the Debtor tasks its employees with researching and evaluating potential investments and opportunities for the Debtor's clients. The Debtor also provides certain back office support for

its clients from time to time. In order to provide such services, the Debtor has directly contracted with various service providers and is required to pay for such services. However, pursuant to the Debtor's expense allocation policy, such expenses are then allocated amongst the Debtor and its various clients either pro rata based on the assets owned by a client or otherwise in a manner consistent with the policy. Consequently, although the Debtor fronts these costs, the Debtor is reimbursed for a portion of such costs by its clients. On a monthly basis, the Debtor generally expects to pay approximately $450,000 for such services and is reimbursed for a substantial majority of such costs by its clients or affiliates.

40. The Cash Management Transactions were approved on an interim basis by order of the Court entered on October 18, 2019 [Docket No. 42] (the "Interim Cash Management Motion"). The Interim Cash Management Motion provided for an aggregate cap on all Cash Management Transactions during the interim period of $1.7 million. As of the date hereof, the Debtor has deployed less than $100,000 with respect to the Cash Management Transactions.

41. **Additional Intercompany Transactions.** In addition to the Cash Management Transactions discussed above, the Debtor, in the ordinary course of its business, obtains and pays for directors' and officers' insurance coverage (the "D&O Insurance"). The Debtor's D&O Insurance is provided by Governance Re Ltd. Governance Re Ltd. is incorporated in Bermuda and is owned indirectly by Mr. Dondero and Mr. Okada. As disclosed above (*see* note 14 *supra*), Mr. Dondero and Mr. Okada are insiders of the Debtor. The Debtor's premiums with respect to its D&O Insurance total $300,000 per annum and are generally paid in the first half of each calendar year (the "D&O Payments," and together with the Cash Management Transactions, the "Intercompany Transactions"). The Debtor believes that the

terms of its D&O Insurance are market rate. Further, the Debtor needs to maintain its D&O Insurance an order to operate in the ordinary course of its business. The Debtor's officers and directors would not continue providing services to the Debtor if they were *not* assured that they would be covered by the D&O Insurance. As such, the Debtor believes that making the D&O Payments are in the best interests of its estate and its creditors.

42. **Continuation in the Ordinary Course.** The Debtor derives substantial value from its operating subsidiaries, and as discussed above, if the Debtor is unable to continue making the Intercompany Transactions it risks losing a substantial amount of that value. Although the Debtor originally requested authority to make the Cash Management Transactions through the Cash Management Motion, the Debtor, through the involvement of the CRO, has come to believe that the Intercompany Transactions, subject to compliance with the Protocols, are consistent with the ordinary course of the Debtor's business. The Debtor and the CRO will continue monitoring the Intercompany Transactions and will disclose to this Court, and seek the necessary approvals of, any Intercompany Transactions they determine are not in the ordinary course.

## Relief Requested

43. By this Motion, the Debtor seeks entry of an order approving (I) the following protocols governing the Debtor's continued operation in the ordinary course of its business with respect to the provision of the Ordinary Course Services and the Intercompany Transactions:

- Notwithstanding any other Protocol to the contrary, the CRO will have all authority and responsibilities set forth in the engagement letter executed on

October 29, 2019 by and between Development Specialists, Inc., and the Debtor (the "Engagement Letter");[24]

- The Debtor may continue to liquidate and purchase securities in the ordinary course of its business in both the Prime Account (subject to Jefferies' consent) and the Select Fund provided that (i) all such trades will be with unaffiliated third parties; (ii) all securities will be sold through either a public or over-the- counter exchange; and (iii) all trades will be disclosed to the CRO.

- The Debtor may continue to invest in its own name as an investor in various companies or investment partnerships managed by independent third parties and make any capital contributions to support these investments, including with respect to the Petrocap Interests, provided that all such transactions are disclosed in advance to the CRO.

- The Debtor may continue to engage in the Intercompany Transactions provided that all such transactions are disclosed in advance to the CRO.

- The Debtor may continue to provide the Investment Management Services, including where the Debtor is a direct or indirect investor in such entities, and to direct its Clients to buy or sell assets and implement restructuring transactions provided that all such purchases, sales, and transactions are disclosed to the CRO

- Any transactions not in the ordinary course will require Court approval; and

- The Debtor will provide a summary, subject to appropriate confidentiality restrictions, of all trades and asset sales or purchases to the Court, the U.S. Trustee, and any statutory committee appointed in this case on a quarterly basis.

(collectively, the "Protocols"); and (II) to the extent required, (a) the Ordinary Course Trades and (b) the Street Name Change, each pursuant to sections 105(a), 363(c)(1), and 363(b) of the Bankruptcy Code.[25]

[24] A copy of the Engagement Letter was filed as Exhibit A to that certain Motion of the Debtor Pursuant to 11 U.S.C. §§ 105(a) and 363(b) to Employ and Retain Development Specialists, Inc. to Provide a Chief Restructuring Officer, Additional Personnel, and Financial Advisory and Restructuring Related Services, *Nunc Pro Tunc* as of the Petition Date, filed concurrently herewith.

[25] The Debtor does not seek, by this Motion, to assume any of its prepetition contracts.

## Authority for the Relief Requested

### A. Section 363(c)(1) of the Bankruptcy Code Authorizes the Debtor to Continue the Ordinary Course Services and to Effectuate Ordinary Course Trades and the Street Name Change in Accordance with Requested Protocols

44. The Debtor is authorized under section 363(c)(1) of the Bankruptcy Code to conduct the Ordinary Course Trades and to continue providing the Ordinary Course Services, including purchasing and selling assets through the Proprietary Accounts, and the Intercompany Transactions. Specifically, section 363(c)(1) provides:

> [i]f the business of the debtor is authorized to be operated under section. . . 1108. . . of this title. . . the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

11 U.S.C. § 363(c)(1). As such, a debtor may enter into postpetition transactions, including the sale or lease of its property, if the debtor is authorized to operate its business under section 1108 and such transactions are "in the ordinary course of business." In the instant case, the Debtor, as a debtor in possession, seeks approval to continue providing the Ordinary Course Services and Intercompany Transactions, subject to the Protocols, and of the Ordinary Course Trades and the Street Name Change.

45. The proposed Protocols ensure, among other things, that the Ordinary Course Services and Intercompany Transactions will be with unaffiliated third parties unless otherwise approved by the CRO. Further, if a transaction does not comply with the Protocols, the Debtor will bring such transaction to this Court's attention. Likewise, the Debtor's proposed Street Name Change is for nominal purposes only and will not affect any substantive rights of the Debtor or anyone else.

46. Additionally, section 105(a) of the Bankruptcy Code empowers the Court to "issue any order . . . that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105 (a). The Protocols requested herein are a reasonable and appropriate limitation on the Debtor's authority in order to ensure transparency during this restructuring process.

47. Under Third Circuit precedent, an activity is "ordinary course" if it satisfies the two-part test adopted in *In re Roth American, Inc.* 975 F.2d 949, 952 (3d Cir. 1992). Under *Roth*, an activity is in the "ordinary course" if it satisfies (i) the "vertical" test, which looks to whether the proposed action is consistent with the Debtor's prepetition business practices and conduct and within "interested parties' reasonable expectations of what transactions the debtor in possession is likely to enter in the course of its business" and (ii) the "horizontal" test, which looks to whether the proposed action "is the sort commonly undertaken by companies in that industry." *Id.*, at 953 (citations omitted). Here, both the vertical test and horizontal test are satisfied.

48. First, each of the Ordinary Course Services, the Intercompany Transactions, and the Ordinary Course Trades are consistent with those effectuated or provided by the Debtor prepetition. Through this Motion, the Debtor seeks (i) the authority – to the extent required – to continue providing the Ordinary Course Services and Intercompany Transactions, subject to the Protocols, in substantially the same manner as it did prior to the Petition Date and (ii) the approval of the Ordinary Course Trades. As such, the "vertical" test is satisfied. The Debtor is seeking to do postpetition what it did prepetition, without substantial variation.

49. Second, the Debtor is a registered investment advisor, and its business is advising clients regarding the purchase, sale, and management of assets. It is also customary in

the Debtor's industry for registered investment advisors to have the authority to cause their clients to buy and sell assets and to manage or restructure such assets without first receiving client consent. In fact, the refusal or inability to conduct such transactions opportunistically and in real time could constitute a breach of the investment advisor's obligation to its clients and potentially its fiduciary obligations. As such, the "horizontal" test is satisfied. The Debtor's continuation of the Ordinary Course Services and Intercompany Transactions, subject to the Protocols, and entrance into the Ordinary Course Trades are consistent with the types of services provided by other investment advisors in the Debtor's industry.

**B. The Debtor's Ordinary Course Services and the Ordinary Course Trades and Street Name Change are a Sound Exercise of Its Business Judgment and in the Best Interests of the Debtor's Estate**

50. Although the Debtor believes that it has the authority to continue the Ordinary Course Services and Intercompany Transactions and to have entered into the Ordinary Course Trades and Street Name Change pursuant to section 363(c)(1), to the extent required, the Debtor submits that the Protocols proposed hereby and the Ordinary Course Trades and Street Name Change also satisfy section 363(b) of the Bankruptcy Code. Section 363(b) provides that "[t]he [Debtor] after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate. . . ." 11 U.S.C. § 363(b).

51. Section 363(b) does not specify a standard for determining when it is appropriate for a court to authorize the use, sale, or lease or property of the estate. However, to satisfy section 363(b), courts have required that such use, sale, or lease be based upon the sound business judgment of the debtor. *See Institutional Creditors of Continental Airlines, Inc. v. Continental Airlines, Inc. (In re Continental Airlines),* 780 F.2d 1223, 1225-26 (5th Cir. 1986);

*Official Comm. of Unsecured Creditors of LTV Aerospace and Def. Co. v. LTV Corp. (In re Chateaugay Corp.),* 973 F.2d 141, 143 (2d Cir. 1992); *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.),* 722 F.2d 1063, 1070 (2d Cir. 1983) (requiring "some articulated business justification" to approve the use, sale or lease of property outside the ordinary course of business); *In re Tropical Sportswear Int'l Corp.,* 320 B.R. 15, 17-18 (Bankr. M.D. Fla. 2005) (applying sound business justification standard in authorizing payment of prepetition claims pursuant to section 363(b)); *In re Delaware & Hudson R.R. Co.*, 124 B.R. 169, 175–76 (D. Del. 1991) (courts have applied the "sound business purpose" test to evaluate motions brought pursuant to section 363(b)).

52. It is clear that there is sufficient business justification for the Debtor's continuation of the Ordinary Course Services and Intercompany Transactions, subject to the Protocols, and the entrance into the Ordinary Course Trades and Street Name Change. As set forth above, the Debtor's business is the provision of the Ordinary Course Services and, if the Debtor is unable to provide the Ordinary Course Services, the Debtor's income will decline precipitously if not catastrophically. Further, if the Debtor is not able to provide the investment services, it risks breaching its various agreements with its Clients and potentially violating its fiduciary duties. For these reasons, as well as all the reasons set forth in this Motion, substantial business justification exists for the Debtor's continued provision of the Ordinary Course Services and Intercompany Transactions and the approval of the Ordinary Course Trades. The proposed Street Name Change also makes business sense under the circumstances.

**Reservation of Rights**

53. Nothing contained in this Motion is intended to be or shall be construed as (i) an admission as to the validity of any claim against the Debtor, (ii) a waiver of the Debtor's or any appropriate party in interest's rights to dispute any claim, or (iii) an approval or assumption of any agreement, contract, program, policy, or lease under section 365 of the Bankruptcy Code. Likewise, if the Court grants the relief sought herein, any obligations honored pursuant to the Court's order are not intended to be and should not be construed as an admission to the validity of any claim or a waiver of the Debtors' rights to dispute such claim subsequently.

**No Prior Request**

54. No previous request for the relief sought herein has been made to this, or any other, Court.

**Notice**

55. Notice of this Motion shall be given to the following parties or, in lieu thereof, to their counsel, if known: (a) the Office of the United States Trustee; (b) the Office of the United States Attorney for the District of Delaware; (c) the Debtor's principal secured parties; (d) counsel to any statutory committee appointed in the case; and (e) parties requesting notice pursuant to Bankruptcy Rule 2002. The Debtor submits that, in light of the nature of the relief requested, no other or further notice need be given.

WHEREFORE, for the reasons set forth herein, the Debtor respectfully requests that the Court enter an Order, substantially in the form attached hereto as **Exhibit A**, approving (I) the Protocols governing the Debtor's continued operation in the ordinary course of its business with respect to the continued provision of Ordinary Course Services, including the

purchase and sale of assets in the Proprietary Accounts and the authorization to direct the purchase, sale, or other disposition of Client assets, and the Intercompany Transactions; and (II) to the extent required, (a) the Ordinary Course Trades and (b) the Street Name Change.

Dated: October 29, 2019

PACHULSKI STANG ZIEHL & JONES LLP

*/s/ James E. O'Neill*

Richard M. Pachulski (CA Bar No. 62337)
Jeffrey N. Pomerantz (CA Bar No.143717)
Ira D. Kharasch (CA Bar No. 109084)
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joneill@pszjlaw.com

*Proposed Counsel for the Debtor and Debtor in Possession*

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

| | | |
|---|---|---|
| In re: | ) | Chapter 11 |
| HIGHLAND CAPITAL MANAGEMENT, L.P.,[1] | ) | Case No. 19-12239 (CSS) |
| Debtor. | ) | |

**Objection Deadline: November 12, 2019 at 4:00 p.m. (ET)**
**Hearing Date: November 19, 2019 at 12:00 p.m. (ET)**

**NOTICE OF PRECAUTIONARY MOTION OF THE DEBTOR FOR ORDER APPROVING PROTOCOLS FOR THE DEBTOR TO IMPLEMENT CERTAIN TRANSACTIONS IN THE ORDINARY COURSE OF BUSINESS**

TO: (a) the Office of the United States Trustee; (b) the Office of the United States Attorney for the District of Delaware; (c) the Debtor's principal secured parties; (d) counsel to any statutory committee appointed in the case; and (e) any party that has requested notice pursuant to Bankruptcy Rule 2002.

**PLEASE TAKE FURTHER NOTICE** that on October 29, 2019, the above-captioned debtor and debtor in possession (collectively, the "Debtor"), filed the *Precautionary Motion of the Debtor for Order Approving Protocols for the Debtor to Implement Certain Transactions in the Ordinary Course of Business* (the "Motion") with the United States Bankruptcy Court for the District of Delaware, 824 Market Street, 3rd Floor, Wilmington, Delaware 19801 (the "Bankruptcy Court"). A copy of the Motion is attached hereto.

**PLEASE TAKE FURTHER NOTICE** that any response or objection to the Motion must be filed with the Bankruptcy Court on or before **November 12, 2019 at 4:00 p.m. (Eastern Time).**

[1] The Debtor's last four digits of its taxpayer identification number are (6725). The headquarters and service address for the above-captioned Debtor is 300 Crescent Court, Suite 700, Dallas, TX 75201.

**PLEASE TAKE FURTHER NOTICE** that at the same time, you must also serve a copy of the response or objection upon: (i) proposed counsel for the Debtor: Pachulski Stang Ziehl & Jones LLP, 919 N. Market Street, 17th Floor, Wilmington, DE 19801, Attn: James E. O'Neill, Esq. (joneill@pszjlaw.com) and Pachulski Stang Ziehl & Jones LLP, 10100 Santa Monica Blvd., 13th Floor, Los Angeles, CA 90067, Attn: Jeffrey N. Pomerantz, Esq. (jpomerantz@pszjlaw.com); and (ii) the Office of the United States Trustee: 844 King Street, Suite 2207, Lockbox 35, Wilmington, DE 19801, Attn: Jane M. Leamy, Esq. (jane.m.leamy@usdoj.gov).

**PLEASE TAKE FURTHER NOTICE** THAT IF YOU FAIL TO RESPOND IN ACCORDANCE WITH THIS NOTICE, THE COURT MAY GRANT THE RELIEF REQUESTED IN THE MOTION WITHOUT FURTHER NOTICE OR HEARING.

**PLEASE TAKE FURTHER NOTICE** THAT A HEARING TO CONSIDER THE RELIEF SOUGHT IN THE MOTION WILL BE HELD ON **NOVEMBER 19, 2019 AT 12:00 P.M. (EASTERN TIME)** BEFORE THE HONORABLE CHRISTOPHER S. SONTCHI, CHIEF UNITED STATES BANKRUPTCY COURT JUDGE, AT THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE, 824 NORTH MARKET STREET, 5TH FLOOR, COURTROOM NO. 6, WILMINGTON, DELAWARE 19801.

Dated: October 29, 2019

PACHULSKI STANG ZIEHL & JONES LLP

*/s/ James E. O'Neill*

Richard M. Pachulski (CA Bar No. 62337)
Jeffrey N. Pomerantz (CA Bar No.143717)
Ira D. Kharasch (CA Bar No. 109084)
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Proposed Counsel for the Debtor and Debtor in Possession

# APPENDIX I

# FORM ADV PART 2A

HIGHLAND CAPITAL
MANAGEMENT, LP

October 16, 2019

300 Crescent Court, Suite 700
Dallas, Texas 75201
(972) 628-4100
www.highlandcapital.com

This brochure provides information about the qualifications and business practices of Highland Capital Management, L.P., an investment adviser registered with the Securities and Exchange Commission. If you have any questions about the contents of this brochure, please contact us at (972) 628-4100. 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 Highland Capital Management, L.P. is also available at the Securities and Exchange Commission's website www.adviserinfo.sec.gov. Our registration as an investment adviser does not imply any level of skill or training.

## ITEM 2. MATERIAL CHANGES

On October 16, 2019, Highland Capital Management, L.P. commenced voluntary Chapter 11 proceedings in the United States Bankruptcy Court for the District of Delaware (the "Court"). Highland's filing stems from a potential judgment being sought against that entity. Although Highland disputes the underlying claims, entry of the judgment in its maximum potential amount could result in a judgment against Highland greater than the entity's liquid assets.

# ITEM 3. TABLE OF CONTENTS

# ITEM 4. ADVISORY BUSINESS

Highland Capital Management, L.P. ("we", "us", "our", "Company", or "Highland") is an investment adviser registered with the SEC and is a global alternative fixed income manager, specializing in bank loans, high yield credit, distressed debt, structured products, real assets, and long-short equities, with a global geographic reach. Our diversified Client base includes public pension plans, foundations and endowments, corporations, financial institutions, fund-of-funds, governments, and high net worth individuals. To best meet the different goals of these investors, we offer a variety of product types, including private equity-style funds, managed separate accounts, hedge funds, and structured product vehicles (e.g., collateralized loan obligations "CLOs").

HISTORY

| | |
|---|---|
| **1990** | James Dondero and Mark Okada (the "Founders") formed a joint venture with Protective Life Insurance Corporation ("Protective Life"), specializing in senior secured loans. |
| **1993** | An agreement established Protective Asset Management Company ("PAMCO"), a SEC-registered investment advisor owned 60% by Protective Life and 40% by the Founders. |
| 1996 | PAMCO launched its first CLO, one of the first non-bank CLOs in the industry. |
| 1997 | The Founders purchased Protective Life's stake, and later that year established Ranger Asset Management, L.P., an independent investment adviser registered with the SEC. |
| 1998 | Ranger Asset Management, L.P. changed its name to Highland Capital Management, L.P. |
| 2004 | Highland acquired the Columbia Floating Rate Fund and Columbia Floating Rate Advantage Fund from Columbia Asset Management, making its entry into the mutual fund business. |
| 2005 | Highland Capital Management Europe, Ltd. was established as an FSA-registered investment adviser in London, through the acquisition of ING Capital Management, Ltd. |
| 2012 | Highland Capital Management Europe, Ltd. sells European CLO business. |

## OWNERSHIP OF HIGHLAND

Highland is controlled by James Dondero through his ownership of Strand Advisors, Inc., Highland's general partner. Substantially all of the non-voting, non-control limited partner interests in Highland are owned by the Hunter Mountain Investment Trust. John Honis, a former partner of Highland, who is also a director of two Highland portfolio companies and of Highland's affiliated registered investment funds, indirectly controls the Trust.

## HIGHLAND REGULATORY ASSETS UNDER MANAGEMENT

Figures are in US$ millions as of 12/31/2018

| | |
|---|---|
| Total Assets Under Management | $5,466.61 |

*By Vehicle Type:*

*Discretionary*

| | |
|---|---|
| Pooled Investment Vehicles and other | $3,278.86 |
| Separate Accounts | $603.57 |

*Non-Discretionary*

| | |
|---|---|
| Unregistered Investment Funds | $1,584.18 |

## OUR ADVISORY SERVICES

Highland provides investment advisory services in several different strategies and types of investment vehicles. Highland makes investment decisions with regard to bank loans, high yield credit, distressed debt, structured products, real assets, and long/short equities. Highland acts as an investment adviser or sub-adviser to structured product vehicles (including but not limited to CLOs and Collateralized Debt Obligations ("CDOs")) ("Structured Product Vehicles"), unregistered investment funds ("Unregistered Investment Funds"), single Client accounts ("Separate Accounts", together with Structured Product Vehicles, Unregistered Investment Funds, "Client Accounts" or "Clients").

TAILORING SERVICES

We tailor our investment advice to the needs of our Clients and are subject to applicable investment restrictions set forth in the governing documents for the applicable Clients.

# ITEM 5. FEES AND COMPENSATION

For providing investment advisory services, Highland typically charges Clients a management fee and/or performance fee or carried interest, and other fees as necessary and agreed to (including, but not limited to, expenses related to servicing accounts, such as administration and legal services).

Under appropriate circumstances and where permitted by applicable law, the terms of an investment advisory contract, including fees, terms of payment and performance fees and termination provisions, are negotiable. In negotiating fees, Highland considers various factors, including assets under management, investment objectives, strategies and restrictions, and the resources required to meet investment objectives.

Clients incur brokerage and other transaction costs associated with Highland's management of Client Accounts. Please see the section titled Brokerage Practices of this ADV Part 2 for a discussion of Highland's brokerage practices.

FEE SCHEDULE

The following summary of fees is typically updated in this brochure annually (on or about March 31) and does not reflect subsequent changes unless expressly indicated otherwise. Fees in the below Fee Schedule are annualized.

| Product | Management Fee | Performance Fee or Carried Interest | Other Fees |
|---|---|---|---|
| Structured Product Vehicles | From 0.15% to 0.85% | From 0.00% to 20.00% | None |
| Separate Accounts | From 0.375% to 1.25% | Up to 20.00% over IRR on some accounts | None |
| Unregistered Investment Funds | From 0.3% to 2.00% | From 0% to 20.00%[1] | None |

Certain investment vehicles managed by Highland invest in other investment vehicles managed by Highland or our affiliates. Both investment vehicles may impose management fees, performance fees or other expenses (including administrative fees). This results in

[1] In limited circumstances where Highland and/or its related parties may agree to bare a disproportionate share of losses, if any, with respect to an account, Highland and/or such applicable related party may contract in advance with such client to receive a performance fee and/or carried interest in excess of 20%.

greater expense to a Client than if such Client had invested directly in the underlying investment vehicle. Certain companies in which Clients are invested also use the products or services, or invest in investment vehicles, offered by Highland or its affiliates and pay fees or other compensation accordingly.

FOR INSTITUTIONAL INVESTORS

*Unregistered Investment Funds*

As compensation for our advisory services, each Unregistered Investment Fund typically pays Highland management fees that range from 0.3% to 2.00% annually. Management fees are based upon outstanding capital accounts or amounts of committed capital and are deducted quarterly in advance or in arrears depending on the specific fund. For accounts that also provide for incentive compensation, Highland also deducts performance fees or investment profit allocations in the form of carried interest ranging from 0% to 20% of returns, which may be after the achievement of a hurdle rate, and which is typically contingent on the manager of the applicable Unregistered Investment Fund eclipsing the high-water mark. In some cases, certain investors in an Unregistered Investment Fund enter into side letter agreements with Highland, under which they may pay a different fee than others based on the terms of their agreement with Highland or may otherwise receive certain additional rights. Upon termination of the applicable Unregistered Investment Fund's advisory agreement, any management fees that have been prepaid are generally returned on a pro-rated basis.

In addition to management fees, performance fees, and brokerage and transaction costs, investors in the Unregistered Investment Funds will indirectly bear the fees and expenses paid by the Unregistered Investment Funds, including custody fees, administration, legal, audit and tax preparation fees, and certain other fees and expenses. Each Unregistered Investment Fund's offering documents include more detailed information about the fees and expenses paid by such Unregistered Investment Fund.

STRUCTURED PRODUCT VEHICLES

As compensation for our advisory services, each Structured Product Vehicle pays Highland management fees ranging from 0.15% to 0.85% annually. Management fees are based on the principal balance of the assets held in the portfolio on defined determination dates. Management fees are established during structuring and remain constant for the duration of the life of the Structured Product Vehicle. Management fees also accrue during a payment period. Highland may also charge performance fees of up to 20% of any remaining interest or principal proceeds after a hurdle rate. Fees are calculated and paid on a quarterly basis by the Trustee in accordance with the governing documents. All fees are paid in arrears on the payment date. In some cases, certain investors in a Structured Product Vehicle pay a

different fee than others based upon, without limitation, the size of the investment and Highland's overall relationship with the investors in the vehicles.

In addition to management fees, performance fees, and brokerage and transaction costs, investors in Structured Product Vehicles will indirectly bear the fees and expenses paid by the Structured Product Vehicle, including administration, legal, audit and accounting fees, and certain other fees and expenses. Each Structured Product Vehicle's governing documents include more detailed information about the fees and expenses paid by such Structured Product Vehicle.

SEPARATE ACCOUNTS

For our Separate Accounts, the agreement entered into with Highland will determine the fee structure. Typically, a Separate Account will pay Highland management fees ranging from 0.375% to 1.25% annually. Management fees are based upon the average daily net assets, which may or may not be net of investment leverage. Highland may also collect a performance fee of up to 20% after reaching an internal rate of return ("IRR").

Please see the section titled Performance-Based Fees and Side-By-Side Management of this ADV Part 2 for additional information regarding performance fees or investment profit allocations in the form of carried interest.

OTHER COMPENSATION

Client Accounts may hold significant positions, individually or collectively, in the securities issued by a company. Accordingly, Highland may have the right to appoint a board member or officer for such company. Highland may appoint an employee or a third party to such position as it sees fit in the best interest of the company and its Clients. Employees are permitted to retain all compensation received for such positions except to the extent contrary to the governing documents for one or more Client Accounts, in which case the proportion of such compensation related to such Client Account(s) will be paid to those Account(s) (generally in proportion to relative assets of the Client Account as of the date paid).

In addition, to the extent permitted by the offering and/or governing documents of the applicable advised accounts, Highland and/or its affiliates receive other fees for services provided to portfolio companies, provided such fees are on arms-length terms. See also Item 10. Other Financial Industry Activities and Affiliations.

We have established procedures designed to address possible conflicts of interest that such board or officer positions might present, including requiring authorization from the Chief Compliance Officer prior to an officer or employee serving as a board member. As a result of such activities, Highland may acquire confidential information, which may restrict Client Accounts from transacting in certain securities. As a result, we may not initiate a transaction on behalf of Clients which we otherwise might have. Additional information regarding

certain conflicts of interest we face is contained in Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading.

# ITEM 6. PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT

As described above, certain Clients pay Highland a performance fee or investment profit allocations in the form of carried interest. To the extent that Highland charges a performance-based fee, the performance-based fee will comply with the requirements of Section 205 and Rule 205-3 under the Investment Advisers Act of 1940 (the "Advisers Act"). In situations where Highland has entered into a performance fee arrangement, it has an economic incentive to make riskier investments and/or pursue riskier strategies than it might otherwise. In addition, because Highland manages both accounts with an asset-based fee and accounts with a performance fee or a combination of an asset-based fee and performance fee, we have an incentive to favor Client accounts for which we receive a performance-based fee. In addition, Highland and its principals also make investments through a number of proprietary accounts, including Highland Capital Management, L.P. In order to mitigate any such conflicts, Highland has developed allocation procedures that are intended to result in fair and equitable allocation over time. To mitigate any actual or perceived conflicts of interest, allocation of limited offering securities (such as IPOs and registered secondary offerings) to principal accounts that do not include third party investors may only be made after all other Client Account orders for the security have been filled. A more detailed summary of our allocation guidelines is available to Clients or prospective Clients upon request. Additional information regarding certain conflicts of interest we face is contained in Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading.

A description of performance-based fees is included in the section titled Fees and Compensation.

# ITEM 7. TYPES OF CLIENTS

Our Clients include:

- Structured Product Vehicles
- Unregistered Investment Funds
- Separate Accounts

Investment advice is provided directly to Clients and not individually to investors in a particular Client.

Highland has minimum account requirements for Unregistered Investment Funds, Structured Product Vehicles and Separate Accounts and generally requires a minimum investment of $100,000 to $50 million depending on the structure. Minimum account size may be waived for certain investors at Highland's discretion.

# ITEM 8. METHODS OF ANALYSIS, INVESTMENT STRATEGIES, AND RISK OF LOSS

The items below are types of investment strategies we currently utilize although we may add or subtract from this list based on various factors including macro-economic conditions.

INVESTMENT STRATEGIES

*Bank Loan Strategy*

Highland's bank loan strategy seeks to generate attractive absolute returns by opportunistically making investments across the capital structure, with a core focus in senior secured bank loans. The bank loan strategy is long-biased and U.S. focused, but has the ability to invest in Canada and Europe.

The strategy may use hedging investments to manage interest rate, default, currency and systemic risks.

*Multi Strategy Credit Strategy*

Highland's Multi-Strategy Credit Strategy is focused across the credit markets in both private and public transactions. It seeks to deliver attractive risk-adjusted returns to its investors by investing, directly or through one or more financing or swap vehicles or other arrangements for obtaining leverage, primarily in (i) bank loans; (ii) other high yield debt; (iii) credit default swaps; (iv) debt and equity securities issued by collateralized loan obligations; and (v) special situation investments. It will take long and short positions.

*Long/Short Equity Strategy*

Highland's long/short equity strategy generally involves a fundamental, bottom-up stock picking style. Investments will be made in value and growth stocks with a domestic focus. The strategy aims to generate equity-like returns over an entire market cycle with less volatility, lower drawdowns, and lower correlation compared to the equity markets. There is generally a strong focus on preservation of capital and risk management. In addition to purchasing or taking "long" positions in equity securities, the strategy will include short selling, investments in derivatives, exchanged-traded funds, or fixed income securities.

Equity securities of U.S. or non-U.S. issuers in which Highland may invest include common stocks, preferred stocks, convertible securities, depositary receipts, warrants to buy common stocks and "derivatives" on any of the foregoing securities. The

exposure of the various funds will vary over time based on assessments of market conditions and other factors.

*Special Situations Strategy*

Highland's special situations strategy employs directional, capital structure arbitrage, relative value, and event-driven investment strategies across various credit markets where Highland holds significant investment experience, primarily the distressed, leveraged loan, high yield and structured products markets. It also utilizes an investment approach to exploit relative value and arbitrage opportunities within these markets. The objective is to maintain low correlation to the broader equity and corporate bond markets, as well as other alternative investment strategies, and to provide attractive risk-adjusted returns on capital. Highland also looks to implement selected trading strategies to exploit pricing inefficiencies across the credit markets and within an individual issuer's capital structure.

*Private Equity Strategy*

The private equity strategy targets investments in the fulcrum securities of distressed credits based in the U.S. and Western Europe. It seeks to capitalize on the following market dynamics: balance sheets remain over levered and companies continue to address looming maturities, while financing markets are bifurcating between good and bad credits. The strategy generally involves investing in undervalued senior secured loans and debt obligations of financially troubled companies to achieve value recoveries via refinancing, at par take-outs or conversions to equity and thereafter create value through operational and financial improvements. This strategy offers a compelling alternative to equity by providing a different downside risk while seeking positive risk-adjusted returns and upside potential in misunderstood industries and companies.

*Floating Rate Loan Strategy*

This strategy seeks to achieve its objective by investing, under normal market conditions, approximately 80% of its net assets in a portfolio of interests in adjustable rate senior loans, the interest rates of which float or vary periodically based upon a benchmark indicator of prevailing interests rates, to domestic or foreign corporations, partnerships and other entities that operate in a variety of industries and geographic regions. The strategy may invest all or substantially all of its assets in senior loans that are rated below investment grade and unrated senior loans of comparable quality. This strategy may also include investments in (i) high quality, short-term debt securities; (ii) warrants, equity securities and junior debt securities; (iii) senior loans of foreign issuers that are foreign currency denominated; and (iv) senior loans the interest rate of which are fixed and do not float.

*Structured Finance Investments*

Highland invests in various structured finance instruments, including asset-backed securities; collateralized loan obligations and collateralized debt obligations; and swaps (including total rate of return swaps) whose rates of return are determined primarily by reference to the total rate of return on one or more loans referenced in such instruments. The rate of return on the structured finance instrument may be determined by applying a multiplier to the rate of total return on the reference loan or loans. Application of a multiplier is comparable to the use of financial leverage, a speculative technique. Leverage magnifies the potential for gain and the risk of loss, because of a relatively small decline in the value of a reference loan could result in a relatively large loss for the value of a structured finance instrument.

METHOD OF ANALYSIS

For all Client Accounts, we utilize both fundamental and technical analysis methods. Our investment philosophy is rooted in a value-oriented, long-term approach, which combines bottom-up research with top-down technical market analysis. Our analysts follow a rigorous and time-tested bottom-up credit analysis for each credit we manage. We have also devised and applied an institutionalized process of credit evaluation and approval, via our Investment Committee, and have built a dedicated experienced restructuring team that has been integrated into Highland's investment process.

Highland's self-discipline is largely enforced by the ongoing monitoring of individual credit names by the responsible analyst and his or her supervisor.

Other sources of information include obtaining and reviewing due diligence packages prepared by debt issuers and underwriters of institutional private placements and meetings with management of issuers.

MATERIAL RISKS OF SIGNIFICANT STRATEGIES AND METHODS OF ANALYSIS:

In this section we summarize some of the material risks of Highland's investment strategies and methods of analysis. More complete information about the specific risks associated with each strategy or Client Account is available in the applicable offering documents. All methods of investments in securities and loans involve risk of loss including risk that a Client will lose the entire value of their investment.

*Allocation of Investments*

There is a risk that the allocations methodology employed by Highland will not result in optimal allocation and may disadvantage one Client Account while benefiting another Client Account. Since the process involves human input there is the risk that

human error may cause harm to a Client Account. Poor or mistaken allocation decisions could result in the loss of money for investors.

*Credit Risk*

Clients engage in transactions in securities and financial instruments that involve counterparties. Under certain conditions, a counterparty to a transaction could default or the market for certain securities and/or financial instruments may become illiquid. There is a risk that the issuer of a fixed income security will be unable to make timely principal and interest payments on the security. Certain Clients invest in securities rated below investment grade (which are commonly referred to as "high yield" securities or "junk" securities). These investments are regarded as predominately speculative with respect to the issuer's continuing ability to meet principal and interest payments. The downgrade of a security held by a Client Account may decrease its value. Securities are subject to varying degrees of credit risk, which are often reflected in ratings assigned by commercial rating companies such as Moody's Investor Service, Standard & Poor's Corporation, Duff & Phelps Credit Rating Co. and Fitch Investors Service.

*Currency Risk*

If a Client Account invests directly in non-U.S. currencies or in securities of issuers that trade in, and receive revenues in, non-U.S. currencies, or in derivatives that provide exposure to non-U.S. currencies, it will be subject to the risk that those currencies will decline in value relative to the U.S. dollar, or, in the case of hedging positions, that the U.S. dollar will decline in value relative to the currency being hedged. Currency rates in foreign countries may fluctuate significantly over short periods of time for a number of reasons, including changes in interest rates, intervention (or the failure to intervene) by U.S. or foreign governments, central banks or supranational entities such as the International Monetary Fund, or by the imposition of currency controls or other political developments in the United States or abroad. As a result, a Client's investments in foreign currency-denominated securities may reduce the returns of the Client Account.

*Derivatives Risk*

Derivatives, such as futures and options, are subject to the risk that changes in the value of a derivative may not correlate perfectly with the underlying asset, rate or index. Derivatives also expose the Client to the credit risk of the derivative counterparty. Derivative contracts may expire worthless and the use of derivatives may result in losses to the Client.

*Frequency of Trading*

Some of the strategies and techniques to be employed by Highland require frequent trades to take place and, as a consequence, portfolio turnover and brokerage commissions will be greater than for other investment vehicles of similar size that do not employ frequent trading techniques.

*Hedging*

Highland may (but is not required to) utilize financial instruments both for investment purposes and for risk management purposes in order to (i) protect against possible changes in the market value of a Client Account resulting from fluctuations in the markets and changes in interest rates; (ii) protect the unrealized gains in the value of a Client Account; (iii) facilitate the sale of any such investments; (iv) enhance or preserve returns, spreads or gains on any investment in a Client Account; (v) hedge against a directional trade; (vi) hedge the interest rate, credit or currency exchange rate on any of financial instruments; (vii) protect against any increase in the price of any financial instruments Highland anticipates purchasing at a later date; or (viii) act for any other reason that the Highland deems appropriate. For a variety of reasons, Highland may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Such imperfect correlation may prevent a Client from achieving the intended hedge or expose the Client to risk of loss. The successful utilization of hedging and risk management transactions requires skills complementary to those needed in the selection of portfolio holdings. Moreover, it should be noted that the Client Account will be exposed to certain risks that cannot be hedged.

*Illiquid Securities*

Highland may cause a Client to invest in a security that is illiquid. This could present a problem in realizing the prices quoted (selling a bond at or near its true value) and in effectively trading the position(s). The primary measure of liquidity is the size of the spread between the bid price and the offer price quoted by a dealer. The greater the dealer spread, the greater the liquidity risk. Liquidity risk is less relevant for investments that are intended to be held until maturity. Lack of liquidity means Highland may not be able to sell such investments at prices that reflect Highland's assessment of their value or the amount paid for such investments. Illiquidity may result from the absence of an established market for the investments as well as legal, contractual or other restrictions on their resale by Highland and other factors. Furthermore, the nature of Highland's investments, especially those in financially distressed companies, may require a long holding period prior to profitability.

*Inflation Risk*

Inflation risk results from the variation in the value of cash flows from a security due to inflation, as measured in terms of purchasing power. For example, if Highland purchases a 5 year bond in which it can realize a coupon rate of 5 percent, but the rate of inflation is 6 percent, then the purchasing power of the cash flow has declined. For securities other than adjustable bonds or floating rate bonds, the investment is exposed to inflation risk because the interest rate the issuer promises to make is fixed for the life of the security. To the extent that interest rates reflect the expected inflation rate, floating rate bonds have a lower level of inflation risk.

*Investments in Distressed Assets*

Debt obligations and other securities of distressed companies will by their nature relate to companies in unstable financial condition and entail substantial inherent risks. Consequently, many of these companies will likely have significantly leveraged capital structures, making them highly sensitive to declines in revenues and to increases in expenses and interest rates. The leveraged capital structure of such investments will increase the exposure of the portfolio companies to adverse economic factors such as downturns in the economy or deterioration in the condition of the portfolio company or its industry. Distressed investing also involves significant expenses of legal counsel, experts, consultants and other third parties.

*Investments in Equity Securities*

Investments in public equities are subject to the risk that stock prices will fall over short or long periods of time. In addition, common stock represents a share of ownership in a company, and rank after bonds and preferred stock in their claim on the company's assets in the event of bankruptcy.

*Investments in Foreign Securities*

A Client may invest a portion of its assets in securities of companies domiciled or operating in one or more foreign countries. Investing in foreign securities involves considerations and possible risks not typically involved in investing in securities of companies domiciled and operating in the U.S., including instability of some foreign governments, the possibility of expropriation, limitations on the use or removal of funds or other assets, foreign currency risk, changes in governmental administration or economic or monetary policy (in the U.S. or abroad) or changed circumstances in dealings between nations. The application of foreign tax laws (e.g., the imposition of withholding taxes on dividend or interest payments) or confiscatory taxation may also affect investment in foreign securities. Higher expenses may result from investment in foreign securities than would from investment in domestic securities because of the costs that must be incurred in connection with conversion between various currencies

and foreign brokerage commissions that may be higher than in the U.S. Foreign securities markets also may be less liquid, more volatile and subject to less governmental supervision than in the U.S., including lack of uniform accounting, auditing and financial reporting standards and potential difficulties in enforcing contractual obligations.

*Investments in Structured Finance Instruments*

Highland may cause Clients to invest in structured finance instruments. A portion of leveraged loans, high yield debt securities, structured finance instruments and synthetic securities (collectively the "Collateral Debt Obligations") may consist of equipment trust certificates, collateralized mortgage obligations, collateralized bond obligations, collateralized loan obligations or similar instruments. Structured finance instruments present risks similar to those of the other types of Collateral Debt Obligations in which the Client may invest and such risks may be of greater significance in the case of structured finance instruments. Moreover, investing in structured finance instruments entails a variety of unique risks, including prepayment risk. In addition, the performance of a structured finance instrument will be affected by a variety of factors, including its priority in the capital structure of the issuer thereof, the availability of any credit enhancement, the level and timing of payments and recoveries on and the characteristics of the underlying receivables, loans or other assets that are being securitized, remoteness of those assets from the originator or transferor, the adequacy of and ability to realize upon any related collateral and the capability of the servicer of the securitized assets. Each structured finance instrument to be purchased by a Client must be rated by a rating agency.

*Investments in Synthetic Securities*

Highland may cause Clients to invest in synthetic securities. In addition to credit risks associated with holding non-investment grade loans and high yield debt securities, with respect to synthetic securities, Highland or its Clients will usually have a contractual relationship only with the counterparty of such synthetic securities, and not the obligor on a reference obligation (the "Reference Obligor"). Such agreement generally stipulates that Highland or its Client will have no right to directly enforce compliance by the Reference Obligor with the terms of the reference obligation (defined herein as the debt security or other obligation upon which the synthetic security is based), nor any rights of set-off against the Reference Obligor, nor have any voting rights with respect to the reference obligation. In addition, in the event of insolvency of the counterparty, the Client will be treated as a general creditor of such counterparty, and will not have any claim with respect to the reference obligation. Consequently, the Client will be subject to the credit risk of the counterparty as well as that of the Reference Obligor. As a result, concentrations of synthetic securities in any one counterparty subject the notes to an additional degree

of risk with respect to defaults by such counterparty as well as by the Reference Obligor. Highland will not perform independent credit analyses of the counterparties, any such counterparty, or an entity guaranteeing such counterparty, individually or in the aggregate.

*Investments in Senior Secured Loans*

Senior secured loans have significant credit risks and material losses may occur. As with other debt obligations, claims and collateral may be difficult to enforce in the event of a default. No assurance can be made that full or significant recovery of principal and/or interest will be received or that any collateral recovered will be marketable or sufficient.

*Leverage*

When deemed appropriate by Highland and subject to applicable regulations, a Client may use leverage in its investment program, including the use of borrowed funds and investments in certain types of options, such as puts, calls and warrants, which may be purchased for a fraction of the price of the underlying securities while giving the purchaser the full benefit of movement in the market of those underlying securities. While such strategies and techniques increase the opportunity to achieve higher returns on the amounts invested, they also increase the risk of loss. To the extent a Client purchases securities with borrowed funds, its net assets will tend to increase or decrease at a greater rate than if borrowed funds are not used. The level of interest rates generally, and the rates at which such funds may be borrowed in particular, could affect the operating results of the Client. If the interest expense on borrowings were to exceed the net return on the portfolio securities purchased with borrowed funds, the Client's use of leverage would result in a lower rate of return than if the Client were not leveraged.

*Maturity Risk*

In certain situations, Highland may purchase a bond of a given maturity as an alternative to another bond of a different maturity. Ordinarily, under these circumstances, Highland will make an adjustment to account for the differential interest-rate risks in the two bonds. This adjustment, however, makes an assumption about how the interest rates at different maturities will move. To the extent that the yield movements deviate from this assumption, there is a yield-curve or maturity risk. Another situation where yield-curve risk should be considered is in the analysis of bond swap transactions where the potential incremental returns are dependent entirely on the parallel shift assumption for the yield curve.

*Market or Interest Rate Risk*

The price of most fixed income securities move in the opposite direction of the change in interest rates. For example, as interest rates rise, the price of fixed income securities fall. If a Client holds a fixed income security to maturity, the change in its price before maturity will have little impact on the Clients performance; however, if the Client has to sell the fixed income security before the maturity date, an increase in interest rates will result in a loss. Senior secured bank loans generally pay interest at rates that are determined periodically by reference to a base lending rate plus a premium. These rates often are re-determined either daily, monthly, quarterly or semi-annually. Recently, domestic and international markets have experienced a period of acute stress starting in the real estate and financial sectors and then moving to other sectors of the world economy. This stress has resulted in unusual and extreme volatility in the equity and debt markets and in the prices of individual investments. These market conditions could add to the risk of short-term volatility of investments.

*Options*

A Client may use a number of option strategies. Put options and call options typically have similar structural characteristics and operational mechanics regardless of the underlying instrument on which they are purchased or sold. A put option gives the purchaser of the option, upon payment of a premium, the right to sell, and the writer the obligation to buy, the underlying security, commodity, index, currency or other instrument at the exercise price. A call option, upon payment of a premium, gives the purchaser of the option the right to buy, and the seller the obligation to sell, the underlying instrument at the exercise price.

With certain exceptions, exchange listed options generally settle by physical delivery of the underlying security or currency, although in the future cash settlement may become available. Index options are cash settled for the net amount, if any, by which the option is "in-the-money" (i.e., where the value of the underlying instrument exceeds, in the case of a call option, or is less than, in the case of a put option, the exercise price of the option) at the time the option is exercised. Frequently, rather than taking or making delivery of the underlying instrument through the process of exercising the option, listed options are closed by entering into offsetting purchase or sale transactions that do not result in ownership of the new option. The Client's ability to close out its position as a purchaser or seller of a listed put or call option is dependent, in part, upon the liquidity of the option market.

Over-the-counter ("OTC") options are purchased from or sold to securities dealers, financial institutions or other parties ("Counterparties") through direct bilateral agreement with the Counterparty. In contrast to exchange listed options, which generally have standardized terms and performance mechanics, all the terms of an

OTC option, including such terms as method of settlement, term, exercise price, premium, guarantee, and security, are set by negotiation of the parties. Unless the parties provide for it, there is no central clearing or guaranty function in an OTC option. As a result, if the Counterparty fails to make or take delivery of the security, currency or other instrument underlying an OTC option it has entered into with the Client or fails to make a cash settlement payment due in accordance with the terms of that option, the Client will lose any premium it paid for the option as well as any anticipated benefit of the transaction.

If a put or call option purchased by the Client were permitted to expire without being sold or exercised, its premium would be lost by the Client. The risk involved in writing a put option is that there could be a decrease in the market value of the underlying security caused by rising interest rates or other factors. If this occurred, the option could be exercised and the underlying security would then be sold to the Client at a higher price than its current market value. The risk involved in writing a call option is that there could be an increase in the market value of the underlying security caused by declining interest rates or other factors. If this occurred, the option could be exercised and the underlying security would then be sold by the Client at a lower price than its current market value. Purchasing and writing put and call options and, in particular, writing "uncovered" options are highly specialized activities and entail greater than ordinary investment risks.

*Short Sales*

A Client may sell securities short. Short selling involves the sale of a security that the Client does not own and must borrow in order to make delivery in the hope of purchasing the same security at a later date at a lower price. In order to make delivery to its purchaser, the Client must borrow securities from a third party lender. The Client subsequently returns the borrowed securities to the lender by delivering to the lender the securities it receives in the transaction or by purchasing securities in the open market. The Client must generally pledge cash with the lender equal to the market price of the borrowed securities. This deposit may be increased or decreased in accordance with changes in the market price of the borrowed securities. During the period in which the securities are borrowed, the lender typically retains his right to receive interest and dividends accruing to the securities. In exchange, in addition to lending the securities, the lender generally pays a fee for the use of the Client's cash. This fee is based on prevailing interest rates, the availability of the particular security for borrowing and other market factors.

*Valuation of Portfolio Investments*

From time to time, special situations affecting the valuation of the investments (such as limited liquidity, unavailability or unreliability of third-party pricing information

and acts or omissions of service providers to the Client) could have an impact on the value of a Client's investment, particularly if prior judgments as to the appropriate valuation of an investment should later prove to be incorrect after a net asset value-related calculation or transaction is completed. Generally, Highland is not required to make retroactive adjustments to prior subscription or withdrawal transactions, management fees or performance allocations based on subsequent valuation data. In addition, Highland may, but is not required to, discount the value of its positions due to limited liquidity, concentration levels or for other reasons. Due to the nature of its investments, Highland may not be able to place a precise value on positions and therefore may need to estimate values.

# ITEM 9. DISCIPLINARY INFORMATION

On September 25, 2014, Highland Capital Management, L.P. ("Highland") entered into a settlement with the Securities and Exchange Commission ("SEC") resulting in the SEC issuing an order. This order resolves the SEC's allegations that Highland violated Sections 204(a) and 206(3) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 204-2 thereunder by trading securities between its Clients' accounts and accounts in which Highland and its principals maintained an ownership interest without adhering to certain requirements set forth by the Advisers Act. The transactions occurred between 2007 and 2009, and many were executed in an effort to generate or maintain liquidity for the advised accounts during September and October 2008. Specifically, the order found that, during the relevant time period, Highland engaged in a number of transactions with its Client advisory accounts without disclosing in writing to those Clients that Highland was acting as principal, or obtaining Client consent to the transactions, before the trades were completed. Highland did ultimately receive Client consent for many of the transactions; however, this consent was received after the transactions had settled, and therefore did not comply with the requirements of Advisers Act Section 206(3). In addition, the order found that, during the relevant time period, Highland failed to keep and maintain true, accurate and current certain books and records as required by the Advisers Act.

The order requires Highland to cease and desist from committing or causing any violations and any future violations of Advisers Act Sections 204(a) and 206(3) and Rule 204-2; censures Highland; and requires Highland to pay a civil monetary penalty of $225,000. Highland was also required to comply with certain undertakings, including retaining an independent consultant to conduct a comprehensive review of Highland's compliance and control systems relating to principal trades, and the creation and retention of its books and records. As of the date hereof, all such undertakings have been successfully completed.

# ITEM 10. OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS

Highland and its advisory affiliates manage various strategies and some strategies are managed by more than one adviser. For this reason, certain Clients of Highland (or Clients of Highland's advisory affiliates) may be referred to and enter into advisory agreements with such affiliated adviser. Neither Highland nor its advisory affiliates charge a fee for such referral.

## BROKER-DEALER, BANKING, AND CONSULTING AFFILIATES

Mr. Dondero indirectly owns a majority interest in NexBank Capital, Inc., whose wholly owned subsidiaries include Nexbank Securities, Inc. (also doing business as Nexbank Capital Advisors and Nexbank Wealth Advisors)("NexBank Securities"), and NexBank SSB. Certain employees of Highland, including James Dondero and Mark Okada, serve on the Board of Directors of Nexbank.

*NexBank Securities, Inc.*

NexBank Securities is a registered broker-dealer and a Member of FINRA/SIPC. It may provide distribution assistance in connection with the sale or placement of funds managed by Highland. NexBank Securities, Inc., also doing business as NexBank Advisors, which is a SEC registered investment adviser.

*NexBank, SSB*

NexBank, SSB, a state chartered bank, is an affiliate of Highland and may, from time to time, provide banking and agency services to portfolio companies in which Client Accounts may be invested. Client Accounts and portfolio companies may invest in assets originated by, or enter into loans, borrowings and/or financings with NexBank, including in primary or secondary transactions. These services generally may result in compensation to NexBank, SSB in various forms, including administrative agent fees, structuring fees, origination and syndication fees, and assignment fees. As a result, we have an incentive to select, or attempt to influence the selection of, NexBank for such services. Fees are charged at rates competitive with those offered by third parties. Highland may also refer Client Accounts or controlled investments to NexBank, SSB for banking services. NexBank, SSB may charge its customary fees for the provision of such banking services.

To the extent permitted by applicable law, NexBank, SSB, may sell or offer participations to Highland Accounts in a variety of commercial loans for which NexBank will receive compensation.

*Nexpoint Securities, Inc. (fka Highland Capital Funds Distributor, Inc.)*

*Nexpoint Securities, Inc.*, a SEC-registered broker dealer and a Member of FINRA/SIPC, is under common control through James Dondero's indirect ownership of *Nexpoint Securities, Inc.* It may provide distribution assistance in connection with the sale or placement of funds managed by Highland.

INVESTMENT ADVISER AFFILIATES

A related person of Highland is the general partner of a number of other collective investment vehicles organized as partnerships including those managed by the following affiliated investment advisers:

*Acis CLO Management, LLC*

Acis CLO Management LLC is a Relying Adviser and files a single Form ADV with Highland, the Filing Adviser. Therefore, Acis CLO Management LLC is under common control with Highland.

*Highland Capital Management Fund Advisors, L.P.*

Highland Capital Management Fund Advisors, L.P. a SEC-registered investment adviser, is under common control with us because James Dondero controls the Highland Capital Management Fund Advisors general partner.

Additionally, Highland Capital Management Fund Advisors serves as advisor or sub-advisor to investment companies registered under the Investment Company Act of 1940, as amended.

*Highland Capital Management Latin America, L.P.*

Highland Capital Management Latin America, L.P. is a Relying Adviser and files a single Form ADV with Highland, the Filing Adviser. Therefore, Highland Capital Management Latin America is under common control with Highland.

*Highland Capital Management Korea Limited*

Highland Capital Management Korea Limited is a Relying Adviser and files a single Form ADV with Highland, the Filing Adviser. Therefore, Highland Capital Management Korea Limited is under common control with Highland.

*Highland HCF Advisor, Ltd.*

Highland HCF Advisor, Ltd. is a Relying Adviser and files a single Form ADV with Highland, the Filing Adviser. Therefore, Highland HCF Advisor is under common control with Highland.

*Highland CLO Holdings, Ltd.*

Highland CLO Holdings, Ltd. is a Relying Adviser and files a single Form ADV with Highland, the Filing Adviser. Therefore, Highland CLO Holdings is under common control with Highland.

*NexPoint Advisors, L.P.*

NexPoint Advisors, L.P., a SEC-registered investment adviser, is under common control with us because James Dondero controls the NexPoint Advisors general partner.

*Nexpoint Insurance Solutions, L.P.*

Nexpoint Insurance Solutions, L.P., a SEC-registered investment adviser, may be deemed to be under common control with us because James Dondero controls this entity.

Thomas Surgent, our Chief Compliance Officer, is also the Chief Compliance Officer of Acis CLO Management, LLC, Highland Capital Management Latin America, L.P., Highland Capital Management Korea Limited, and Highland HCF Advisor, Ltd. Jason Post is the Chief Compliance Officer of Highland Capital Management Fund Advisors, L.P., and NexPoint Advisors, L.P. Eric Holt is the Chief Compliance Officer of NexBank Securities, Inc., also doing business as NexBank Wealth Advisors and Nexpoint Insurance Solutions, L.P..

In addition Highland is a party to Shared Services Agreement with each of these advisors, under which Highland provides certain administrative and back office services to such

advisors, including finance and accounting, human resources, marketing, legal, information technology and operations.

INSURANCE COMPANY AFFILIATES

Highland Capital Management Services, Inc. is an affiliate of Highland and parent company of Governance Re Ltd., a captive insurance agency issuing directors & officers' liability insurance and employment practice liability insurance to Highland its affiliates, and their respective portfolio companies. NexVantage Title Services is a title insurance company affiliated with NexBank and Highland, which may provide title insurance with respect to real property investments owned by Client Accounts or their portfolio companies. A conflict of interest exists due to the fact that these entities receive premiums from portfolio companies and/or Client Accounts. As a result, Highland is incentivized to choose these affiliates to provide these services over a third party even though such party's services may be better suited for the company. Other Highland affiliates may provide insurance related products or services from time to time to Clients and/or portfolio companies and receive arm's length fees for such services. See "Conflicts of Interest," in the section titled Code of Ethics, Participation of Interest in Client Transactions and Personal Trading.

INDEPENDENT BUSINESS ENTITIES

Employees, including the owners, of Highland also own personal interests in a variety of independent business entities. A conflict of interest exists due to the potential for the owners' personal relationships and financial interests to conflict with our Client's interests.

BUSINESS ACTIVITIES WITH PORTFOLIO COMPANIES

Highland or its affiliates provide on a periodic basis certain services to portfolio companies including, but not limited to, forensic accounting, interim management consulting services and merger and acquisition advisory services. Highland or our affiliates may also furnish operational consulting services to certain portfolio companies of Highland's Clients. The time spent by Highland with respect to such activities depends upon a number of factors including the size of the investment, the relationship with the portfolio company and the financial and strategic position of such company. Highland or its affiliated advisors (including employees) may be directly or indirectly compensated for such services provided such compensation is received as a result of an arm's length contract between the company and such person. Employees of Highland may be granted equity or options in the portfolio companies for which they provide certain services.

Additional information regarding potential conflicts of interest arising from Highland's relationship and activities with its affiliates is provided in the section titled Code of Ethics, Participation or Interest in Client Transactions and Personal Trading.

# ITEM 11. CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING

Highland maintains a policy of strict compliance with the highest standards of ethical business conduct and the provisions of applicable federal securities laws, including rules and regulations promulgated by the SEC, and has adopted policies and procedures described in its Code of Ethics. The Code of Ethics applies to each employee of Highland and any other "access person" as defined under the Advisers Act. It is designed to ensure compliance with legal requirements of Highland's standard of business conduct.

A complete copy of Highland's Code of Ethics is available to any Client or prospective Client upon request.

## STANDARDS OF CONDUCT

Highland and its access persons are expected to comply with all applicable federal and state laws and regulations. Access persons are expected to adhere to the highest standards of ethical conduct and maintain confidentiality of all information obtained in the course of their employment and bring any risk issues, violations, or potential violations to the attention of the Chief Compliance Officer. Access persons are expected to deal with Clients fairly and disclose any activity that may create an actual or potential conflict of interest between them and Highland or Client.

## ETHICAL BUSINESS PRACTICES

Falsification or alteration of records or reports, also known as a prohibited financial practice, or knowingly approving such conduct is prohibited. Payments to government officials or employees are prohibited except for political contributions approved by our Chief Compliance Officer. We seek to outperform our competition fairly and honestly and seek competitive advantages through superior performance not illegal or unethical dealings. Access persons are strictly prohibited from (i) participating in online blogging and communication with the media, unless approved by the Chief Compliance Officer or the Compliance Department, and (ii) spreading of false rumors pertaining to any publicly traded company.

## CONFIDENTIALITY

Employees must maintain the confidentiality of Highland's proprietary and confidential information, and must not disclose that information unless the necessary approval is obtained. Highland has a particular duty and responsibility, as investment adviser, to safeguard Client information. Information concerning the identity and transactions of investors is confidential, and such information will only be disclosed to those employees and outside parties who need to know it in order to fulfill their responsibilities.

GIFT AND ENTERTAINMENT POLICY

Access persons are permitted, on occasion, to accept gifts and invitations to attend entertainment events. When doing so, however, employees should always act in our best interests and that of our Clients and should avoid any activity that might create an actual or perceived conflict of interest or impropriety in the course of our business relationship. Under no circumstances may (i) gifts of cash or cash equivalents be accepted or (ii) may any gifts be received in consideration or recognition of any services provided to or transactions entered into by, Client Accounts.

PERSONAL TRADING

*Personal Trading Policy*

Access persons are allowed to trade reportable securities during designated time periods, however all transactions in reportable securities other than ETFs must be pre-approved by the Chief Compliance Officer or his/her designee. Except in very limited circumstances approved by the Chief Compliance Officer, access persons are not permitted to trade any security of which we or a Client own any portion of the capital structure or that is on our restricted list without permission. Access persons who violate the personal trading policy are reprimanded in accordance with the sanctions provisions outlined in the Code of Ethics. Personal securities transactions are reviewed by the Chief Compliance Officer or his/her designee for compliance with the personal trading policy and applicable SEC rules and regulations.

*Prohibition against Insider Trading*

Highland forbids any access person from trading, either personally or on behalf of others, including Clients advised by Highland, on material non-public information or communicating material non-public information to others in violation of the law or duty owed to another party. This conduct is frequently referred to as "insider trading". The concepts of material non-public information, penalties for insider trading, and processes for identifying insider trading are addressed in detail in the Compliance Manual and Code of Ethics.

*Reporting Requirements*

In compliance with SEC rules, access persons are required to disclose all of their personal brokerage accounts and holdings within 10 days of initial employment with Highland, within 10 days of opening a new account, and annually thereafter. Additionally, the last day of the month following each quarter-end, all access persons must report all transactions in reportable securities over which the access person had any direct or indirect beneficial ownership. Access persons are also required annually to affirm all reportable transactions from the prior year.

POTENTIAL CONFLICTS

Highland, its affiliates and their respective officers, directors, trustees, stockholders, members, partners and employees and their respective funds and investment accounts (collectively, the "Related Parties") engage in a broad range of activities, including activities for their own account and for the accounts of Clients. This section describes various potential conflicts that may arise in respect of the Related Parties, as well as how we address such conflicts of interest. The discussion below does not describe all conflicts that may arise.

Any of the following potential conflicts of interest will be discussed and resolved on a case by case basis. Our determination as to which factors are relevant, and the resolution of such conflicts, will be made using our best judgment, but in our sole discretion. In resolving conflicts, we will take into consideration the interests of the relevant Clients, the circumstances giving rise to the conflict and applicable laws. Certain procedures for resolving specific conflicts of interest are set forth below.

*Allocation of Investment Opportunities*

Highland, together with its affiliated advisors (the "Related Advisors"), acts as investment adviser to Clients that have similar investment objectives and pursue similar strategies. Certain investments identified by the Related Advisors may be appropriate for multiple Clients. Investment decisions for such Clients are made by the applicable Related Advisors in their best judgment, but in their discretion, taking into account such factors as they believe relevant. Such factors may include investment objectives, regulatory restrictions, current holdings, availability of cash for investment, the size of investments generally, risk-return considerations, tax consequences, and limitations and restrictions on a Client's Account that are imposed by such Client. In addition, if it is fair and reasonable that certain Clients are fully filled of their appetite before others (e.g., for tax considerations, to avoid de minimis partial allocations, to cover or close out an existing position to mitigate risk or losses, etc.), then these Clients may receive full or disproportionate allocations, with the remaining amounts allocated in accordance with normal procedures among the other participating Clients. One or more of the foregoing considerations in this paragraph may (and are often expected to) result in allocations among accounts other than on a pari passu basis. Accordingly, particular investment may be bought or sold for only one Client or in different amounts and at different times for more than one but less than all Clients, even though it could have been bought or sold for other Clients at the same time. Likewise, a particular investment may be bought for one or more Clients when one or more other Clients are selling the investment. In addition, purchases or sales of the same investment may be made for two or more Clients on the same date. There can be no assurance that a Client will not receive less (or more) of a certain investment than it would otherwise receive if the applicable Related Advisors did not have a conflict of interest among Clients.

In effecting transactions, it is not always possible, or consistent with the investment objectives of the Related Advisors' various Clients, to take or liquidate the same investment positions at the same time or at the same prices. Certain investment restrictions may limit the Related Advisors' ability to act for a Client and may reduce performance. Regulatory and legal restrictions (including restrictions on aggregated positions) may also restrict the investment activities of the Related Advisors and result in reduced performance.

The Related Advisors seek to manage and/or mitigate these potential conflicts of interest described by following procedures with respect to the allocation of investment opportunities their Clients, including the allocation of limited investment opportunities. Our allocation policy is based on a fundamental desire to treat each Client Account fairly over time.

In addition to the investment strategies implemented by the portfolio managers for each of our Clients, such portfolio managers may also give trading desk personnel of the adviser general authorization to enter into a limited amount of short-term trades (purchases expected to be sold within 15 business days) in debt instruments on behalf of such Clients. Over time, it is expected that these trades will not exceed 2% of each such Client's assets. Such investments executed by authorized traders are generally allocated on a weighted rotational basis, based on the AUM of the accounts eligible to participate in such investment opportunities.

*Investment Negotiation*

In order to ensure compliance with Section 17(d) under the Investment Company Act whenever an investment professional proposes to negotiate a term other than price for an investment (including any amendments), he/she must check to see if the investment (or any other position in the issuer's capital structure) is held (or proposed to be invested) in any retail accounts of our advisory affiliates.

If the investment is held in any retail accounts, that person must contact the Chief Compliance Officer for guidance.

(i) The transaction is generally permitted if all accounts are in the same part of the capital structure and participate in the investment pro rata

(ii) Alternatively, impose "Chinese Wall" between retail/institutional investment decision-making

One person can negotiate, provided final investment decision still made separately.

May also consult outside counsel and/or the retail board for guidance.

*Capital Structure Conflicts*

Conflicts will arise in cases when Clients of the Related Advisors invest in different parts of an issuer's capital structure, including circumstances in which one or more Clients own private securities or obligations of an issuer and other Clients may own public securities of the same issuer. In addition, one or more Clients may invest in securities, or other financial instruments, of an issuer that are senior or junior to securities, or financial instruments, of the same issuer that are held by or acquired for, one or more other Clients. If such issuer encounters financial problems, decisions related to such securities (such as over the terms of any workout or proposed waivers and amendments to debt covenants) will raise conflicts of interests. For example, a Client holding debt securities of the issuer may be better served by a liquidation of the issuer in which it may be paid in full, whereas a Client holding equity securities of the issuer might prefer a reorganization that holds the potential to create value for the equity holders.

In the event of conflicting interests within an issuer's capital structure, the Related Advisors will generally pursue the strategy that reflects what would be expected to be negotiated in an arm's length transaction with due consideration being given to our fiduciary duties to each of our accounts (without regard to the nature of the fees received from such accounts):

- This strategy may be recommended by one or more investment professionals of the Related Advisors
- A single person may represent more than one part of an issuer's capital structure
- The recommended course of action will be presented to our Conflicts Committee for final determination as to how to proceed. We may elect, but are not required, to assign different teams to make recommendations for different parts of the capital structure as the Conflicts Committee determines in its discretion.
- It is acknowledged that the applicable retail portfolio manager will separately and independently make his or her decision on suitability as to the course of action for the applicable retail portfolio and will leave the Conflicts Committee meeting prior to the final determination being made by the Conflicts Committee.

The Related Advisors may elect, but are not required, to assign different teams to make recommendations for different parts of the capital structure as the Conflicts Committee determines in its discretion.

In the event any Related Parties serve on the Board of the subject company, they may recuse themselves from voting on transactions involving a capital structure conflict.

- Related Party board members may still make recommendations to the Conflicts Committee

- If any such persons are also on the Conflicts Committee, they may recuse themselves from the Committee's determination.

The Related Advisors may use external counsel for guidance and assistance.

The foregoing procedures are not applicable to the advisors to retail accounts, which advisors generally make their own independent determination as to the course of action that is most appropriate for the applicable retail accounts.

*Position Conflicts*

Another type of conflict may arise if we cause one Client account of a Related Advisor to buy a security and another Client account to sell or short the same security. Currently, such opposing positions are generally not permitted within the same account without prior trade approval by the Chief Compliance Officer. However, a portfolio manager may enter into opposing positions for different Clients to the extent each such Client has a different investment objective and each such position is consistent with the investment objective of the applicable Client. In addition, transactions in investments by one or more affiliated Client accounts may have the effect of diluting or otherwise disadvantaging the values, prices or investment strategies of other Client accounts.

Generally, a Related Advisor does not purchase, sell or hold securities on behalf of Clients contrary to the current recommendations made to other affiliated Client accounts. However, because certain Client accounts may have investment objectives, strategies or legal, contractual, tax or other requirements that differ (such as the need to take tax losses, realize profits, raise cash, diversification, etc.), a Related Advisor may purchase, sell or continue to hold securities for certain Client accounts contrary to other recommendations. In addition, a Related Advisor may be permitted to sell securities or instruments short for certain Client accounts and may not be permitted to do so for other affiliated Client accounts.

*Principal Trading*

The Related Advisors, through their ownership interest in certain Unregistered Investment Funds, may be deemed a *related person* of such entity. In situations where we determine that we are a *related person* by our ownership of greater than 25% of such entity, such fund is considered a "*Principal Account.*"

To the extent a Related Advisor wishes to trade an asset from a Client account to or from a Principal Account (a "Principal Cross Trade"), the SEC has stated that the Principal Cross Trade may only occur if the Client account on the other side from the Principal Account consents to the trade after a disclosure by the Related Advisor of

all material facts. Our Compliance Manual sets forth procedures for executing both cross trades and principal cross trades.

*Cross Trading*

In an effort to reduce transaction costs, increase execution efficiency, and capitalize on timing opportunities, we may execute cross trades, or sell a security for one affiliated Client to another affiliated Client, without interposing a broker-dealer. All cross trades are subject to the cross trade procedures set forth in our Compliance Manual. Cross trades present an inherent conflict of interest because we and/or our affiliates represent the interest of the buyer and seller in the same transaction. As a result, Clients involved in a cross trade bear the risk that the price obtained from a cross trade may be less favorable than if the trade had been executed in the open market.

*Conflicts Related to Investment Activities*

The Related Advisors may buy or sell the same securities for an affiliate's account that they buy or sell for a Client or may pursue the same investment strategies for an affiliate's account as for a Client's. The Related Advisors also may receive greater management or performance-based fees or incentives in connection with managing certain Client accounts than from other Client accounts. In addition, if the Related Advisors allocate a Client's assets among pooled vehicles managed by the Related Advisors, they may have an incentive to allocate assets into vehicles that produce the greatest fees for the Related Advisors. Each of these situations give rise to a potential conflict of interest in the allocation of investment opportunities. In addition, the Related Advisors have an incentive to resolve conflicts of interest in favor of affiliated Clients over non-affiliated Clients. As previously described, the Related Advisors adopted trade allocation policies and procedures that seek to ensure fair and equitable access to investment opportunities for all accounts.

*Trade Aggregation*

In some circumstances, the Related Advisors may seek to buy or sell the same securities contemporaneously for multiple Client accounts. The Related Advisors may, in appropriate circumstances, aggregate securities trades for a Client with similar trades for other Clients, but are not required to do so. In particular, the Related Advisors may determine not to aggregate transactions that relate to portfolio management decisions that are made independently for different accounts or if the Related Advisors determine that aggregation is not practicable, not required or inconsistent with Client direction. When transactions are aggregated and it is not possible, due to prevailing trading activity or otherwise, to receive the same price or execution on the entire volume of securities purchased or sold, the various prices may be averaged or allocated on another basis deemed to be fair and equitable. In addition,

under certain circumstances, the Clients will not be charged the same commission or commission equivalent rates in connection with a bunched or aggregated order. The effect of the aggregation may therefore, on some occasions, either advantage or disadvantage any particular Client.

From time to time, aggregation may not be possible because a security is thinly traded or otherwise not able to be aggregated and allocated among all affiliated Client accounts seeking the investment opportunity or a Client may be limited in, or precluded from, participating in an aggregated trade as a result of that Client's specific brokerage arrangements. Also, an issuer in which Clients wish to invest may have threshold limitations or aggregate ownership interests arising from legal or regulatory requirements or company ownership restrictions, which may have the effect of limiting the potential size of the investment opportunity and thus the ability of the applicable Client to participate in the opportunity.

*Company Errors*

For the Company's Clients, the Company's responsibility for its trade errors is set forth in the governing documents for the relevant Client. No soft-dollars may be used to satisfy any trade errors. In addition, the Company may not use the securities in one Client's account to settle the trade error in another Client's account.

*Conflicts Related to Valuation*

The Related Advisors may have a role in determining asset values with respect to Client accounts and may be required to price an asset when a market price is unavailable or unreliable. This may give rise to a conflict of interest because a Related Advisor may be paid an asset-based fee on certain Client accounts. In order to mitigate these conflicts, the Related Advisors determine asset values in accordance with valuation procedures, which generally are set forth in their applicable Compliance Manual.

*Conflicts Related to Investments in Affiliated Funds*

The Related Advisors purchase for Client accounts interests in other pooled vehicles, including Structured Product Vehicles, Unregistered Investment Funds and Retail Funds, offered by Related Parties. Investment by a Client in such a vehicle means Related Parties receive advisory or other fees from the Client in addition to advisory fees charged for managing the Client's Account. The details of any possible fee offsets, rebates or other reduction arrangements in connection with such investments are provided in the documentation relating to the relevant Client account and/or underlying investment vehicle. In choosing between vehicles managed by Related Parties and those not affiliated with Related Parties, Related Parties may have a financial incentive to choose Related Parties-affiliated vehicles over third parties by

reason of additional investment management, advisory or other fees or compensation Related Parties may earn. The potential for fee offsets, rebates or other reduction arrangements may not necessarily eliminate this conflict and Related Parties may nevertheless have a financial incentive to favor investments in Related Parties-affiliated vehicles. If the Related Advisors invest in an affiliated vehicle, a Client should not expect the Related Advisors to have better information with respect to that vehicle than other investors may have (and if the Related Advisors do have better information they may be prohibited from acting upon it in a way that disadvantages other investors).

Additionally, Related Parties may sponsor and manage funds and accounts that compete with the Related Advisors or make investment with funds sponsored or managed by third-party advisers that would reduce capacity otherwise available to the Related Advisors' Clients.

*Other Potential Conflicts*

Related Parties may provide services other than advice to a Client, including administration, organizing/managing business affairs, executing and reconciling trades, preparing financials and providing audit support, preparing tax documents, sales and investor relations support, and diligence and valuation services, for additional fees. A potential conflict arises in such circumstances because Related Parties are incentivized to favor its Clients that pay such additional fees. However, the individuals who provide advice to Clients do not provide these additional services.

The Related Advisors may cause a Client to purchase, sell or hold securities of issuers in which Related Parties make a market or has an equity, debt or other financial interest or securities of issuers or other investments in which Related Parties, their officers or employees or their affiliated broker-dealers and other Related Parties and their officers or employees have positions or other financial interests. For example, the Related Advisors may purchase on behalf of a Client unregistered securities for which an affiliate acts as placement agent, which may result in additional fees to the affiliate or assist the affiliate in meeting its contractual obligations. The Related Advisors may also cause a Client to borrow money from Related Parties, and the Related Parties may earn interest or fees on such transactions. Conflicts also may arise if the Related Advisors implement a portfolio decision or strategy (including a decision to hold an investment) for one Client ahead of, or contemporaneously with, another Client. Such transactions may have the effect of diluting or otherwise disadvantaging the values, prices or investment strategies of other Client accounts and could result in one Client receiving more favorable trading results or reduced costs at the expense of the other Client.

Related Parties may invest (or recommend that a Client invest) in securities issued by a Client and may hedge derivative positions by buying or selling securities issued by a Client. A potential conflict may arise in such circumstances because a Related Advisor may be incentivized to favor its Clients that issue securities, or such Clients of its affiliates, over other Clients. In addition to Clients, some of the Related Advisors' service providers are issuers of securities. The Related Advisors may determine that it is in the best interests of a Client to purchase securities issued by one of these entities. The Related Advisors have adopted policies and procedures designed to address conflicts of interest arising from the foregoing activities. Furthermore, it is the Related Advisors' general policy not to take into account the fact that an issuer is a Client, service provider or vendor when making investment decisions.

Certain qualified employees and affiliates may invest in Clients either through general partner entities or as limited partners, shareholders or otherwise. The Related Advisors generally reduce or waive all or a portion of the management fee, performance-based fee related to the investments by such persons.

*Conflicts Related to Information Possessed by or Provided by the Related Advisors*

Certain Related Parties may receive or create information (*e.g.*, proprietary technical models) that is not generally available to the public. The Related Advisors have no obligation to provide such information to Clients or effect transactions for Clients on the basis of such information and in many cases the Related Advisors will be prohibited from trading for the same Clients based on the information. Similarly, some Clients may have access to information regarding Related Parties' transactions or views that is not available to other Clients, and may act on that information through accounts managed by persons other than Related Parties. Such transactions may negatively impact other Clients (*e.g.*, through market movements or decreasing availability or liquidity of securities). Additionally, our personnel or those of our advisory affiliates may from time to time serve on the board of directors of portfolio companies, and in such capacity may recommend investment opportunities to such companies.

*Conflicts Related to the Related Advisors' Relationships with Third Parties*

The Related Advisors may advise third-parties regarding valuation, risk management, transition management and potential restructuring or disposition activities in connection with proprietary or Client investments, which may create an incentive to purchase securities or other assets from those third parties or engage in related activities to bid down the price of such assets, which may have an adverse effect on a Client.

The Related Advisors may work with pension or other institutional investment consultants and such consultants may also provide services to the Related Advisors. Consultants may provide brokerage execution services to Related Parties and Related Parties may attend conferences sponsored by consultants. The Related Advisors also may be hired to provide investment management or other services to a pension or other institutional investment consultant that works with a Client, which may create conflicts.

Related Parties may in-source or out-source to third parties certain processes or functions, which may give rise to conflicts. There may be conflict when negotiating with third-party service providers if Related Parties bear operational expenses of various Clients to the extent that a given fee structure would tend to place more expense on Clients for which Related Parties have a greater entitlement to reimbursement or less expense on Clients for which Related Parties have lesser (or no) entitlement to reimbursement. Related Parties may provide information about a Client's portfolio positions to unrelated third parties to provide additional market analysis and research to Related Parties and they may use such analysis to provide investment advice to other Clients.

Related Parties may purchase information (such as periodicals, conference participation, papers, surveys) from professional consultant firms, and such firms may have an incentive to give favorable evaluations of Related Parties to their Clients.

In selecting broker-dealers that provide research or other products or services that are paid with soft dollars, conflicts may arise between a Related Advisor and a Client because a Related Advisor may not produce or pay for these benefits but may use brokerage commissions generated by Client transactions. Soft dollar arrangements may also give a Related Advisor an incentive to select a broker-dealer based on a factor other than the Related Advisor's interest in receiving the most favorable execution. Conflicts of interest related to soft dollar relationships with brokerage firms may be particularly influential to the extent that a Related Advisor uses soft dollars to pay expenses it might otherwise be required to pay itself. Furthermore, research or brokerage services obtained using soft dollars or that are bundled with trade execution, clearing, settlement or other services provided by a broker-dealer may be used in such a way that disproportionately benefits one Client over another (*e.g.*, economics of scale or price discounts). For example, research or brokerage services paid for through one Client's commission may not be used in managing that Client's account. Additionally, where a research product or brokerage service has a mixed-use, determining the appropriate allocation of the product or service may create conflicts. Please refer to the section titled Brokerage Practices for information regarding the Related Advisors' use of soft dollars.

Conflicts may arise where a Related Advisor has the responsibility and authority to vote proxies on behalf of its Clients. Please refer to the section titled Voting Client Securities for information regarding the policies and procedures governing the Related Advisors' proxy voting activities.

Related Parties may serve on the boards of directors and/or investment committees of external organizations, including those organizations that are currently or may become Clients of Related Parties, and such service may present conflicts of interest to the extent the employee become aware of material non-public information and may be unable to initiate some transactions for other Clients while in possession of that information.

The Related Advisors may conduct business with institutions such as broker dealers or investment banks that invest, or whose Clients invest, in pooled vehicles sponsored or advised by the Related Advisors, or may provide other consideration to such institutions or recognized agents, and as a result the Related Advisors may have a conflict of interest in placing its brokerage transactions.

Related Parties may receive stock options from companies, the securities of which may be held in accounts of Related Parties' Clients, in exchange providing consulting work, including but not limited to, advisory services and financial services, for those companies.

*Other Accounts and Relationships*

As part of our regular business, Highland and its Related Parties hold, purchase, sell, trade or take other related actions both for their respective accounts and for the accounts of their respective Clients, on a principal or agency basis, subject to applicable law including Section 206(3) of the Advisers Act, with respect to loans, securities and other investments and financial instruments of all types. The Related Parties also provide investment advisory services, among other services, and engage in private equity, real estate and capital markets-oriented investment activities. The Related Parties will not be restricted in their performance of any such services or in the types of debt, equity, real estate or other investments which they may make. The Related Parties may have economic interests in or other relationships with respect to investments made by Clients. In particular, but subject to Highland's personal trading policy the Related Parties may make and/or hold an investment, including investments in securities, that may compete with, be pari passu, senior or junior in ranking to an, investment, including investments in securities, made and/or held by Clients or in which partners, security holders, members, officers, directors, agents or employees of such Clients serve on boards of directors or otherwise have ongoing relationships. Each of such ownership and other relationships may result in restrictions on transactions by Clients and otherwise create conflicts of interest for

Clients. In such instances, the Related Parties may in their discretion make investment recommendations and decisions that may be the same as or different from those made with respect to Client investments, subject to the capital structure conflicts procedures discussed above. In connection with any such activities described above, but subject to Highland's personal trading policy the Related Parties may hold, purchase, sell, trade or take other related actions in securities or investments of a type that may be suitable for Clients. Subject to Highland's personal trading policy, the Related Parties will not be required to offer such securities or investments to Clients or provide notice of such activities to Clients. In addition, in managing Client portfolios, each of the Related Advisors may take into account its relationship or the relationships of its affiliates with obligors and their respective affiliates, which may create conflicts of interest. Furthermore, in connection with actions taken in the ordinary course of business of the Related Advisors in accordance with their fiduciary duties to their other Clients, the Related Advisors may take, or be required to take, actions which adversely affect the interests of their Clients.

The Related Parties have invested and may continue to invest in investments that would also be appropriate for Clients. Such investments may be different from those made on behalf of Clients. No Related Advisor nor any Related Party has any duty, in making or maintaining such investments, to act in a way that is favorable to Clients or to offer any such opportunity to Clients, subject to Highland's allocation policy and personal trading policy. The investment policies, fee arrangements and other circumstances applicable to such other parties may vary from those applicable to Clients. Any Related Party may also provide advisory or other services for a customary fee with respect to investments made or held by Clients, and no stockholders nor Clients shall have any right to such fees except to the extent the governing documents of the applicable Client expressly provide otherwise. Any Related Party may also have ongoing relationships with, render services to or engage in transactions with other Clients, who make investments of a similar nature to those of Clients, and with companies whose securities or properties are acquired by Clients and may own equity or debt securities issued by Clients. In connection with the foregoing activities any Related Party may from time to time come into possession of material nonpublic information that limits the ability of the Related Advisors to effect a transaction for Clients, and Client investments may be constrained as a consequence of the Related Advisors' inability to use such information for advisory purposes or otherwise to effect transactions that otherwise may have been initiated on behalf of its Clients.

Although the professional staff of the Related Advisors will devote as much time to Clients as they deem appropriate to perform their duties, the staff may have conflicts in allocating its time and services among Client accounts.

The directors, officers, employees and agents of the Related Parties may, subject to applicable law, serve as directors (whether supervisory or managing), officers, employees, partners, agents, nominees or signatories, and receive arm's length fees in connection with such service, for Clients or any Related Party, or for any Client joint ventures or any affiliate thereof, and no Clients nor their stockholders shall have the right to any such fees except to the extent the governing documents of the applicable Client expressly provide otherwise.

The Related Parties serve or may serve as officers, directors or principals of entities that operate in the same or a related line of business as Clients, or of other investment funds managed by Related Advisors. In serving in these multiple capacities, they may have obligations to other Clients or investors in those entities, the fulfillment of which may not be in the best interests of Clients or their stockholders. Clients may compete with other entities managed by Related Advisors for capital and investment opportunities.

There is no limitation or restriction on Related Advisors with regard to acting as investment manager (or in a similar role) to other parties or persons. This and other future activities of Related Parties may give rise to additional conflicts of interest. Such conflicts may be related to obligations that Related Advisor or their affiliates have to other Clients.

Certain Related Parties, including NexBank SSB and Governance Re among others, may provide banking, agency, insurance and other services to Clients and their operating affiliates for customary fees, and no Client, nor its subsidiaries will have a right to any such fees except to the extent the governing documents thereof expressly provide otherwise.

Related Advisors may direct Clients to acquire or dispose of investments in cross or principal trades involving Clients of the Advisory Parties in accordance with applicable legal and regulatory requirements as described above. In addition, Clients may make and/or hold an investment, including an investment in securities, in which Related Parties have a debt, equity or participation interest, and the holding and sale of such investments by Clients may enhance the profitability of Related Parties' own investments in such companies. Moreover, Clients and their operating affiliates may invest in assets originated by, or enter into loans, borrowings and/or financings with Related Parties, including but not limited to NexBank, including in primary and secondary transactions with respect to which Related Parties may receive customary fees from the applicable issuer, and no Client nor their subsidiaries shall have the right to any such fees except to the extent the governing documents of such Client expressly provide otherwise. In each such case, Related Parties may have a potentially conflicting division of loyalties and responsibilities regarding Clients and the other parties to such investment. Under certain circumstances, the Related

Advisors may determine that it is appropriate to avoid such conflicts by selling an investment at a fair value that has been calculated pursuant to our valuation procedures to another fund managed or advised by the Related Advisors. In addition, the Related Advisors may enter into agency cross-transactions where it or any of its affiliates act as broker for Clients, to the extent permitted under applicable law.

Related Parties may act as an underwriter, arranger or placement agent, or otherwise participate in the origination, structuring, negotiation, syndication or offering of investments purchased by Clients. Such transactions are on an arm's-length basis and may be subject to arm's-length fees. There is no expectation for preferential access to transactions involving investments that are underwritten, originated, arranged or placed by Related Parties and no Client nor their stockholders shall have the right to any such fees except to the extent the governing documents of such Client expressly provide otherwise.

*Material Non-Public Information*

There are generally no ethical screens or information barriers among the Related Advisors and certain of their affiliates of the type that many firms implement to separate persons who make investment decisions from others who might possess material, non-public information that could influence such decisions. If any Related Advisor, any of their personnel or affiliates were to receive material non-public information about an investment or issuer, or have an interest in causing a Client to acquire a particular investment, we may be prevented from causing the Client to purchase or sell such asset due to internal restrictions imposed on us. Notwithstanding the maintenance of certain internal controls relating to the management of material non-public information, it is possible that such controls could fail and result in the Related Advisors, or one of its investment professionals, buying or selling an asset while, at least constructively, in possession of material non-public information. In addition, while the Related Advisors and certain of their affiliates generally operate without information barriers on an integrated basis, such entities could be required by certain regulations, or decide that it is advisable, to establish information barriers. In such event, our ability to operate as an integrated platform could also be impaired, which would limit our access to personnel of our affiliates and potentially impair our ability to manage Client investments.

# ITEM 12. BROKERAGE PRACTICES

## BROKER-DEALER SELECTION

Highland has an obligation to obtain "best execution" for Client transactions considering the execution price and overall commission costs paid and certain other factors. Our trading desk routes orders to various broker-dealers for execution at their discretion. Where possible, we deal directly with the dealers who make a market in the securities involved, except in those circumstances where we believe better prices and execution are available elsewhere.

Through periodic meetings of the Brokerage Committee, Highland reviews compensation paid to broker-dealers. The meetings include an in-depth review of "best execution reports" which are third party reports that show how Highland's execution compared to its peers. The reports also include information regarding the most used broker-dealers, lowest and highest cost broker-dealers, and other information used in reviewing broker-dealer selection and compensation.

Factors involved in selecting brokerage firms include:

*Broker Specific*

- Size of broker
- Reputation
- Quality of service
- Experience
- Financial stability and creditworthiness
- Financial statements
- Regulatory filings
- Standing in financial community
- Ability to handle block trades
- Acceptable record of delivery and payment on past transactions
- Quality of research and investment information provided

*Transaction Specific*

- Best available execution

- Market knowledge regarding specific industries and securities
- Access to sources of supply or markets
- Nature of the market for the security

THE APPROVAL PROCESS

Highland's trading desk is only allowed to trade with broker-dealers that are approved by our Brokerage Committee unless interim approval is expressly provided by the Compliance Department, in which case such approval shall be ratified by the Brokerage Committee at the next meeting of the Committee. New broker-dealers are added to Highland's approved list of broker-dealers subject to a formal review process which closely analyzes all of the above mentioned broker specific selection items. The Brokerage Committee reviews the requirements and determines what additional procedures or reporting are necessary.

Highland generally has discretion to select brokers for its Clients that are pooled investment vehicles, such as, Retail Funds and Unregistered Investment Funds. For the Retail Funds, the Board of Trustees/Directors of each Retail Fund is ultimately responsible for the oversight of the Retail Fund and has the authority to direct or limit the brokers that may be used for the particular Retail Fund.

SOFT DOLLARS

In those circumstances where more than one broker-dealer is able to satisfy our obligation to obtain best execution, Highland may place a trade order on behalf of Client Accounts with a broker-dealer that charges more than the lowest available commission cost or price. Highland may do this in exchange for certain brokerage and research services provided either directly from the broker-dealer or through a third party ("Soft Dollar Arrangements"), provided that each of the following is met:

- Highland determines:

    1. The research or brokerage product or service constitutes an eligible brokerage or research service;
    2. The product or service provides lawful and appropriate assistance in the performance of Highland's investment decision making responsibilities; and
    3. In good faith the amount of Client commissions paid is reasonable in light of the value of the products or services provided.

- The brokerage or research is "provided by" a broker-dealer who participates in effecting the trade that generates the commission. Highland may not incur a direct obligation for research with a third party vendor and then arrange to have a broker-dealer pay for that research in exchange for brokerage commissions.

- Highland may only generate soft dollars with commissions in agency transactions. Highland may not use dealer markups in principal transactions to generate soft dollars. In addition, a trade for a fixed income security or over-the-counter ("OTC") security may be done on an agency basis only if the trader determines that it would not result in a broker-dealer unnecessarily being inserted between Highland and the market for that security.

- No soft dollars are generated on accounts for which:

    1. Investment discretion resides with the Client (i.e. non-discretionary accounts);
    2. Client mandates restrict or prohibit the generation of soft dollar commissions;
    3. The Client has a directed brokerage arrangement.

- The brokerage trade placed is for "securities" transactions (and not, for example, futures transactions).

Research services furnished by brokers through whom Highland effects securities transactions may be used in servicing all of Highland's accounts, and not all such services may be used in connection with the accounts which paid commissions to the broker providing such services.

If a Client Account is under the custody of one brokerage firm and another brokerage firm is a selling group member for an underwriting syndicate, such a Client Account may not be able to participate in the purchase of securities in the underwriting because the custodial brokerage firm was not a selling group member. In addition, to the extent that a Client directs brokerage trades to be placed with a particular broker, the allocation of securities transactions may be impacted.

When Highland uses Client brokerage commissions (or markups or markdowns) to obtain research or other products or services, Highland receives a benefit because the firm does not have to produce or pay for research, products, or services. Consequently, Highland may have an incentive to select or recommend a broker-dealer based on our interest in receiving the research or other products or services, rather than Clients' interest in receiving most favorable execution.

PRODUCTS AND SERVICES ACQUIRED WITH SOFT DOLLARS

All products and services acquired with soft dollars qualify under the Safe Harbor of 28(e) of the Securities Exchange Act of 1934. Examples of eligible services and products include independent stock research, economic research, research in specific industry sectors, real time feeds, newswires, strategic analysis, and back office systems.

DIRECTED BROKERAGE

Highland does not require Clients to direct brokerage, but in those situations where a Client has directed Highland to place trades with a particular broker-dealer, Highland may not be free to seek the best price, volume discounts or best execution by placing transactions with other broker-dealers. Additionally, as a result of directing Highland to place trades with a particular broker-dealer, a disparity in commission charges may exist between the commissions charged to Clients who direct us to use a particular broker-dealer and those Clients who do not direct us to use a particular broker-dealer as well as a disparity among the brokers to which different Clients have directed trades.

TRADE AGGREGATION

Orders of Clients may be combined (or "bunched") when possible to obtain volume discounts resulting in a lower per share commission. Please see the section entitled Code of Ethics, Participation or Interest in Client Transactions, and Personal Trading for additional information regarding Highland's trade aggregation procedures.

# ITEM 13. REVIEW OF ACCOUNTS

## ACCOUNT REVIEW

Highland has an Investment Committee which, subject to certain size thresholds, is responsible for (i) assessing and approving new issues and new credits and (ii) determining general account suitability for those investments.

In circumstances where the decision to buy is made outside of the Investment Committee (i.e. where limited quantity purchases are allowed or with respect to follow-on investments), allocations will be made by consultation with the Portfolio Managers, typically from a "Gatekeepers" email request sent by or at the direction of the requesting Portfolio Manager. In determining the aggregate amount to be sought, the Investment Committee and/or Portfolio Managers consider, without limitation, the normal investment amount of the account, the general level of cash on hand and available to be drawn, cash generating activities, withdrawals and other factors affecting the desired purchase amount for Clients. The Investment Committee also may reconsider buy decisions relating to existing Client holdings when there are significant changes in relevant factors relating to the investment, including, but not limited to, the market value of the investment, the business of the issuer or borrower, results of operations, balance sheet and creditworthiness of the issuer or in the case of an equity security, the outlook for the issuer. An initial target allocation is determined by the committee at the time of any buy or sell decision based on appropriate factors (e.g., suitability, cash needs/availability, transaction size, etc.) which is then reconciled and adjusted, as appropriate, by the Allocation Committee prior to the commencement of trading on the next trading day. Our fiduciary duty requires that we recommend only those investments that are suitable for a Client, based on the Client's particular investment objectives, needs and circumstances. We are responsible for inquiring and documenting the criteria discussed above and shall develop suitable investment guidelines for each Client.

*Traders Book*

In certain circumstances, our Authorized Traders, as from time to time amended, determine that an investment is a good short-term opportunity for technical trading reasons. In these cases, an Authorized Trader propose these investment ideas to the Portfolio Managers who will consider the short-term investment based on the facts known to them and presented by the Authorized Trader. If the Portfolio Managers agree to participate in the short-term trade, the Authorized Trader executes the trade for the benefit of those accounts. The trade will then follow our Allocation Policy for immediate term investments.

*Equities*

Investment decisions with respect to equity investments are generally made independently by each applicable Portfolio Manager and allocated solely within the accounts managed by such Portfolio Manager, provided that in certain circumstances, such as debt to equity conversions, such determination may be presented to the Investment Committee in accordance with the process typically applicable to credit investments.

Investments in all Client Accounts are reviewed periodically and are reviewed collectively and individually by multiple reviewers in order to provide multiple perspectives on the accounts. Reviewers evaluate Client objectives along with, among other factors, applicable portfolio restrictions, available cash, particularized investment suitability, investment performance and diversification. In addition to, and not as a substitute for the foregoing, additional reviews are conducted in accordance with Client requests as set forth in the relevant investment advisory contract.

NATURE AND FREQUENCY OF REPORTING

Client reporting varies based on the type of product/vehicle. The following summarizes the reporting provided to each Client. The reports provided to a Client within a particular investment product/vehicle may differ from our description depending upon strategies and Client needs.

*Structured Product Vehicles*

Investors in Structured Product Vehicle Clients generally have access to a written monthly report provided by the trustee and the ability to review a marked portfolio on a monthly basis. The monthly trustee report primarily includes compliance reporting and portfolio holdings.

*Unregistered Investment Funds – Hedge Funds*

Investors in Hedge Fund Clients are generally provided a written monthly account statement with their respective net asset value. They also receive a written monthly reporting package, which includes a one-page summary with a fund overview, market commentary, and Highland's outlook on the market. In addition, the report includes fund specific details around the portfolio statistics, composition, and attribution.

On a quarterly basis, Highland may hold a conference call for a portfolio update with the Portfolio Manager, which will be accompanied by a written presentation to provide an update on the portfolio as well as the credit markets.

In addition to the above mentioned reporting, investors also receive audited written financial statements on an annual basis.

*Unregistered Investment Funds – Private Equity Funds*

Investors in Private Equity Fund Clients are provided a quarterly written capital statement with their respective investment commitments and capital balances, as well as periodic capital call written notices describing amounts being called on commitments and a detailed description of the use of proceeds.

On a quarterly basis, Highland may hold a conference call for a portfolio update with the Portfolio Manager, which will be accompanied by a written presentation to provide an update on the portfolio holdings.

In addition to the above mentioned reporting, investors also receive annual audited written financial statements.

*Separate Accounts*

Separate Account Clients typically have reporting that is tailored based on their expressed desired format and frequency. However, in general, the reporting Highland provides Separate Account Clients mirrors that of Hedge Fund Client written reporting. Reports to Separate Account Clients may be customized to include more detailed statistics, holdings, etc., at the request of the Client since there are generally fewer limitations on the type of information Highland can share regarding their investments. In addition to this reporting, Separate Account Clients have the ability to access the portfolio holdings as they deem necessary through the custodian of the account. An audit may or may not be required depending on the Client.

# ITEM 14. CLIENT REFERRALS AND OTHER COMPENSATION

As stated in Item 12, we may allocate portfolio transactions to brokers or dealers who provide research and/or related services. For a more detailed discussion of such practices, please refer to Item 12.

Employees of Highland Capital Funds Distributor, Inc. are compensated based on their activities in soliciting investors through FINRA and/or SEC registered intermediaries for Clients advised by our advisory affiliates and may be similarly compensated in respect of our future Clients.. These employees are compensated with a base salary and discretionary bonus. Unaffiliated persons may from time to time serve as solicitors for Highland and may be compensated for referrals. Any agreement with a solicitor will be in compliance with Rule 206(4)-3 of the Advisers Act.

# ITEM 15. CUSTODY

Highland does not act as custodian for Client assets. However, under Rule 206(4)-2 under the Advisers Act, Highland is deemed to have custody of certain Client assets. In the case of Retail Funds and Unregistered Investment Funds, such Clients have made arrangements with qualified custodians as disclosed in the relevant offering and other fund documents. In addition, such Clients obtain additional financial statements which statements are provided to investors no later than 120 days following the fiscal year end. With respect to Structured Product Vehicles, the trustee has custody of the Client's assets in accordance with the relevant offering and other fund documents.

In the case of Separate Accounts, Clients may give Highland the power to withdraw funds or securities maintained with a custodian upon request. Without coming to a legal conclusion as to whether Highland would have custody over these assets, Highland operates as if it does have custody in such situations. Accordingly, unless an exception is available, any Separate Account Clients would receive an annual surprise custody audit and receive account statements from their broker-dealer, bank, or qualified custodian and should carefully review those statements. Separate Accounts Clients should carefully review those statements and, to the extent Highland also delivers statements to such Clients, compare the Highland statement to the statements of the qualified custodian. For tax and other purposes, the custodial statement is the official record of a Separate Account Client's account and assets.

Loans held in Client Accounts may be agented by NexBank, SSB. As Agent Bank, NexBank, SSB will receive cash or send cash to such Clients for interest or principal payments or borrowings. Client Accounts (other than Retail Funds) may also have bank accounts or account control agreements in place at NexBank, SSB. In such instances NexBank receives an independent control examination pursuant to Rule 206(4)-2.

# ITEM 16. INVESTMENT DISCRETION

Highland advises a wide variety of Client Accounts and manages assets on a discretionary basis. For a description of limitations Clients may impose on our discretionary authority to manage securities, please see the section titled Our Advisory Business.

Highland accepts discretionary authority to manage Clients' assets through an investment management agreement with its Clients.

Additionally, before an investment may be made into an Unregistered Investment Fund, or other similar structure, Highland provides all potential investors in the fund with an offering document, which sets forth in detail the investment strategy and program. By completing the subscription documents to acquire an interest or shares in an Unregistered Investment Fund, investors give us complete authority to manage the capital contributed in accordance with the offering document received.

# ITEM 17. VOTING CLIENT SECURITIES

## SECURITIES HELD IN CLIENT ACCOUNTS

Highland's proxy voting policy ensures proxies are voted on behalf of each Client Account's securities and in the best economic interests of such Client Account, without regard to the interests of Highland or any other Client of Highland. Portfolio Manager(s) of the applicable Client Account(s) evaluate the subject matter of each proxy and vote on behalf of the Client Account in accordance to the guidelines set forth in our proxy voting policy. In any case where a Client has instructed the Company to vote in a particular manner on the Client's behalf, those instructions will govern in lieu of parameters set forth in the proxy voting policy.

If the Portfolio Manager(s) determines that Highland may have a potential material conflict of interest, whether actual or perceived, in voting a proxy, the Portfolio Manager(s) will contact Highland's Compliance Department prior to the voting deadline. In the event of a conflict, the Company may choose to address such conflict by: (i) voting in accordance with the Proxy Advisor's recommendation; (ii) the CCO determining how to vote the proxy (if the CCO approves deviation from the proxy advisor's recommendation, then the CCO shall document the rationale for the vote); (iii) "echo voting" or "mirror voting" the proxy in the same proportion as the votes of other proxy holders that are not Clients; or (iv) with respect to Clients other than Retail Funds, notifying the affected Client of the material conflict of interest and seeking a waiver of the conflict or obtaining such Client's voting instructions.

## OBTAINING A COPY OF THE POLICY

Clients and prospective Clients can obtain a copy of the proxy voting policy or information on how Highland voted proxies by contacting Highland's Chief Compliance Officer at (972) 628-4100.

# ITEM 18. FINANCIAL INFORMATION

Highland does not charge or solicit pre-payment of more than $1200 in fees per Client six or more months in advance.

Highland has discretionary authority or custody of Client funds or securities. There is no financial condition that is reasonably likely to impair our ability to meet contractual commitments to Clients.

On October 16, 2019, Highland Capital Management, L.P. commenced voluntary Chapter 11 proceedings in the United States Bankruptcy Court for the District of Delaware (the "Court"). Highland's filing stems from a potential judgment being sought against that entity. Although Highland disputes the underlying claims, entry of the judgment in its maximum potential amount could result in a judgment against Highland greater than the entity's liquid assets.

## ITEM 19. REQUIREMENTS FOR STATE-REGISTERED ADVISERS

Not Applicable.

# APPENDIX II

## Appendix II

| Transaction Type | Trade Date | Settle Date | Account | Net Proceeds |
|---|---|---|---|---|
| Sale | 10/23/19 | 10/25/19 | Select Fund | $203,969.93 |
| Sale | 10/23/19 | 10/25/19 | Select Fund | $134,748.82 |

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

| | | |
|---|---|---|
| In re: | ) | Chapter 11 |
| HIGHLAND CAPITAL MANAGEMENT, L.P.,[1] | ) | Case No. 1919-12239 (CSS) |
| Debtor. | ) | |

**ORDER APPROVING PROTOCOLS FOR THE DEBTOR TO IMPLEMENT CERTAIN TRANSACTIONS IN THE ORDINARY COURSE OF BUSINESS**

Upon the *Precautionary Motion of the Debtor for Order Approving Protocols for the Debtor to Implement Certain Transactions in the Ordinary Course* (the "Motion"),[2] filed by the above-captioned debtor and debtor in possession (the "Debtor"); the Court having reviewed the Motion, and finding that (a) the Court has jurisdiction over this matter pursuant to 28 U.S.C. §§157 and 1334, (b) this is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A), and (c) notice of this Motion having been sufficient under the circumstances and no other or further notice is required; and having determined that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and having determined that the relief sought in the Motion is in the best interests of the Debtor and its estate; and after due deliberation and sufficient cause appearing therefore,

IT IS HEREBY ORDERED THAT:

1. The Motion is GRANTED on the terms and conditions set forth herein.

[1] The Debtor's last four digits of its taxpayer identification number are (6725). The headquarters and service address for the above-captioned Debtor is 300 Crescent Court, Suite 700, Dallas, TX 75201.

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Motion.

2. The Debtor is authorized, but not required, to provide the Ordinary Course Services and Intercompany Transactions, as requested in the Motion, subject to the following Protocols:

- Notwithstanding any other Protocol to the contrary, the CRO will have all authority and responsibilities set forth in the Engagement Letter;
- The Debtor may continue to liquidate and purchase securities in the ordinary course of its business in both the Prime Account (subject to Jefferies' consent) and the Select Fund provided that (i) all such trades will be with unaffiliated third parties; (ii) all securities will be sold through either a public or over-the- counter exchange; and (iii) all trades will be disclosed to the CRO.
- The Debtor may continue to invest in its own name as an investor in various companies or investment partnerships managed by independent third parties and make any capital contributions to support these investments, including with respect to the Petrocap Interests, provided that all such transactions are disclosed in advance to the CRO.
- The Debtor may continue to engage in the Intercompany Transactions provided that all such transactions are disclosed in advance to the CRO.
- The Debtor may continue to provide the Investment Management Services, including where the Debtor is a direct or indirect investor in such entities, and to direct its Clients to buy or sell assets and implement restructuring transactions provided that all such purchases, sales, and transactions are disclosed to the CRO
- Any transactions not in the ordinary course will require Court approval; and
- The Debtor will provide a summary, subject to appropriate confidentiality restrictions, of all trades and asset sales or purchases to the Court, the U.S. Trustee, and any statutory committee appointed in this case on a quarterly basis.

3. The Ordinary Course Trades and the Street Name Change are approved.

4. Nothing herein or in the Motion shall be deemed to constitute an assumption of any executory contract, whether under section 365 of the Bankruptcy Code or otherwise.

5. Notwithstanding any stay under applicable Bankruptcy Rules, this Order shall be effective immediately upon entry.

6. The Court shall retain jurisdiction over all matters arising from or related to the interpretation and implementation of this Order.

Dated: _____, 2019

CHIEF JUDGE CHRISTOPHER S. SONTCHI
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

| | | |
|---|---|---|
| In re: | ) | Chapter 11 |
| HIGHLAND CAPITAL MANAGEMENT, L.P.,[1] | ) | Case No. 19-12239 (CSS) |
| Debtor. | ) | |

**CERTIFICATE OF SERVICE**

I, James E. O'Neill, hereby certify that on the 29th day of October, 2019, I caused a copy of the following document(s) to be served on the individual(s) on the attached service list(s) in the manner indicated:

**Notice of Precautionary Motion of the Debtor for Order Approving Protocols for the Debtor to Implement Certain Transactions in the Ordinary Course of Business**

**Precautionary Motion of the Debtor for Order Approving Protocols for the Debtor to Implement Certain Transactions in the Ordinary Course of Business**

*/s/ James E. O'Neill*
James E. O'Neill (Bar No. 4042)

[1] The Debtor's last four digits of its taxpayer identification number are (6725). The headquarters and service address for the above-captioned Debtor is 300 Crescent Court, Suite 700, Dallas, TX 75201.

Highland Capital 2002 Service List FCM
Case No. 19-12239 (CSS)
Document No. 225797
01 – Interoffice Mail
09 – Hand Delivery
51 – First Class Mail

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