ALTERNATIVE INVESTMENT TRUST

ASIC Regulatory Guide 240 – Hedge Funds: Improving Disclosures

January 2014

THE TRUST COMPANY

Index

THE TRUST COMPANY

1. Executive summary

The Trust Company (RE Services) Limited ("The Trust Company" or the "Responsible Entity") in its capacity as responsible entity of Alternative Investment Trust ("AIT") and Laxey Partners (UK) Limited ("Laxey" or the "Investment Manager") are pleased to provide the responses to the benchmarks and disclosure principles contained in ASIC Regulatory Guide 240 – "*Hedge Funds: Improving Disclosures*".

Presented below is our detailed response to each of the items raised in RG 240.

<u>Background to AIT</u>

The investment portfolio of Alternative Investment Trust ("AIT") primarily consists of exposure to a basket of absolute return funds via a swap agreement with Macquarie Bank ("the Swap"). In January 2009, a unitholder vote determined that the fund should pursue an orderly wind up under a new investment manager, Laxey Partners (UK) Ltd ("Laxey") – formally appointed manager on 23 February 2009 – and a new responsible entity, The Trust Company (RE Services) Limited. Laxey is a part of Isle of Man based Laxey Partners Ltd. Laxey Partners Ltd was founded in 1998 as a globally active management company and manages a range of assets and funds for institutional investors. As part of the new mandate, the name of the fund was changed from Everest, Babcock & Brown Alternative Investment Trust to Alternative Investment Trust. In order to make distributions from investments redeemed within the Swap, AIT was required to repay the Swap related debt. This repayment was completed in August 2010, and AIT has since been free to make distributions to unitholders once sufficient cash has built up.

2. Benchmarks for hedge funds

In this section the Responsible Entity sets out its responses to the benchmarks listed in Section B to RG240.

Benchmark	Benchmark satisfied (Yes / No)	Details
1. The Responsible Entity has and implements a policy that requires valuations of the hedge fund's assets that are not exchange traded to be provided by an independent administrator or an independent valuation service provider	Yes	All assets held within the swap are valued on a regular basis by either the underlying fund's investment manager or the investment administrator. These valuations are assessed by AIT's Investment Manager and its third party administrator on a monthly basis. None of these parties is a related entity of the Responsible Entity.
2. The responsible entity has and implements a policy to provide periodic reports on certain key information (as set out in Appendix 1)	Yes	The Responsible Entity and Laxey provide a monthly fact sheet to unitholders which contains all of the information listed in Appendix 1. The most recent fact sheet is available at www.thealternativeinvestmenttrust.com or at www.asx.com.au. Additionally, the half-yearly and annual financial statements include a detailed report from the Investment Manager. These reports contain all of the information listed for annual disclosure. The Responsible Entity and Laxey believe that the information provided to investors in these documents, as well as in the annual and half yearly financial statements and other ongoing disclosures made to the ASX are sufficient to allow unitholders to make an informed decision about AIT.

THE TRUST COMPANY

3. Disclosure principles for hedge funds

Introduction

This section sets out the Responsible Entity's responses to the disclosure principles listed in section C of RG240.

Disclosure Principle 1: Investment Strategy

AIT is being wound down; as such, the Investment Portfolio is in "run-off" and AIT will not be acquiring any new assets or investments. AIT's main asset is its exposure to a basket of absolute return funds via a swap agreement with Macquarie Bank. AIT also holds direct investments in the Everest Babcock and Brown Income Fund ("EBBIF") and the Babcock and Brown CDO Fund, together with a limited amount of cash. The wind down process has been managed so as to provide the maximum amount of cash to unitholders over as short a time period as is deemed prudent and within the context of firstly having repaid the leverage facility provided by Macquarie Bank Limited. As such, the Investment Manager together with Macquarie Bank Limited monitors the liquidity profile and redemption terms of each investment. All holdings that may be redeemed are in the process of being redeemed, with some positions subject to lock ups, illiquid side pocket arrangements (a type of account used to separate illiquid assets from other more liquid investments) or a queuing process. Once an investment enters a side pocket account, only the present unitholders in the fund will be entitled to a share of it. Future investors will not receive a share of the proceeds in the event the asset's returns are realised. Further commentary on liquidity can be found under Disclosure Principle 6.

AIT is exposed to credit risk, foreign exchange risk, interest rate risk, market price risk and liquidity risk arising from the financial instruments it holds. The risk management policies employed to manage these risks are discussed below.

(a) Credit risk

Credit risk is the risk that counterparty will fail to perform contractual obligations, either in whole or in part, under a contract and cause AIT to incur a financial loss. In relation to derivative financial instruments, credit risk arises from the potential failure of counterparties to meet their obligations under the contract or arrangement. Many counterparties of the underlying investments to which AIT is exposed are located outside Australia, which can increase the complexity and costs of enforcing AIT's rights. Credit risk is minimised by ensuring counterparties, together with the respective credit limits are assessed and monitored.

(b) Liquidity and cash flow risk

Liquidity risk is the risk that AIT will experience difficulty in either realising assets or otherwise raising sufficient funds to satisfy commitments associated with financial instruments or satisfy creditors' concerns of AIT. Cash flow risk is the risk that the future cash flows derived from holding financial instruments will fluctuate. The Investment Manager manages the cash flow risk by preparing monthly cash flow forecasts to ensure that upcoming commitments can be met by AIT, as and when they fall due.

(c) Market price risk

Market price risk is the risk that the value of AIT's investment portfolio will fluctuate as a result of changes in market variables such as interest rates, foreign exchange rates and equity prices or will be adversely affected as a result of market illiquidity. This risk is managed by ensuring that all activities are transacted in accordance with investment guidelines. AIT is subject to the restrictions set out under the Swap agreement with Macquarie Bank Limited.

(d) Foreign exchange risk

AIT is exposed to foreign exchange risk as a result of investments in financial instruments denominated in foreign currencies, including the Swap which is denominated in US dollars. AIT has exposure to foreign currency risk implicit in the value of portfolio securities denominated in a foreign currency and transactional exposure arising from purchase or sale of securities. The Investment Manager and Responsible Entity have not hedged AIT's exposure to the US Dollar; however when funds are available in the swap these are converted from US Dollars into Australian Dollars and transferred to AIT's Australian Dollar denominated bank account.

(e) Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. AIT has exposure to interest rate risk with respect to the cash balance held.

Changing the investment strategy

Unitholder approval would be required to change the investment strategy.

Disclosure Principle 2: Investment manager

Background on Laxey

On the 5th February, 2009, The Trust Company (RE Services) Limited was appointed at a meeting of unitholders as the responsible entity for AIT. The Responsible Entity appointed Laxey Partners (UK) Limited ("Laxey") as Investment Manager on the 23rd February, 2009.

Since its appointment Laxey has managed the Trust according to a revised investment strategy (see Disclosure Principle 1 investment strategy), to undertake an orderly wind down of AIT, with a programme for the realisation of assets to optimise the return on investments to unitholders.

Laxey is part of Laxey Partners Ltd, based on the Isle of Man in the British Isles and founded in 1998. Since its creation, Laxey Partners has led over fifty closed-end fund investments, including orderly wind downs such as the mandate for the management of AIT.

Laxey Partners (UK) Limited is authorised and regulated by the Financial Conduct Authority firm reference number 196936. Laxey Partners Ltd is licensed by the Financial Supervision Commission of the Isle of Man. There have been no adverse regulatory findings against the investment manager to date.

Laxey Partners (UK) Limited and Laxey Partners Ltd have certain key individual staff who along with staff of the Responsible Entity manage the day to day running of AIT. The following outlines the main key roles and experience of these staff members:

Managing Director

Joined Laxey Partners Ltd in February 2001, becoming an executive director in December 2001. Extensive knowledge of the fund/investment industry. Responsibilities include risk management, coordination, integration and protection of the company's IT systems and fund management investment tools. Holds a 2:1 Honours degree in Accounting and Financial Management Bsc (Econ).

Investment Manager

Joined Laxey in September 2008, having completed a number of short placements with them between June 2006 and July 2007. Awarded a First and Gold Medal in Mathematics and Philosophy from Trinity College, Dublin, and a research master's degree (B.Phil.) in Philosophy from the University of Oxford.

Key duties include, corresponding with the underlying investment managers to understand AIT's underlying exposure and its liquidity and risk profiles, making any recommendations to the Responsible Entity in terms of corporate actions on the underlying assets and distributions to unitholders. Preparation of information for unitholders on the realisation programme undertaken by the Responsible Entity and Laxey.

Operations Manager

Joined Laxey Partners Ltd in November 2009. Prior to joining Laxey, worked in the fund industry since 1996. Roles included being Senior Fund Administration Manager, which involved managing a team of 30+ fund administrators and managing key client relationships aswell as being part of the senior management team. Qualified ACCA Accountant.

Key duties include, corresponding with AIT's other service providers to ensure a good level of service is maintained and to assist in the review of the Trust's NTA, financial statements and any other reporting. Make any recommendations to the Responsible Entity in terms of fees of the Trust.

Head of Finance

Joined Laxey Partners Ltd in January 2006. Before joining Laxey, worked in the financial services industry for 8 years, which included having a role as Accounts Manager. Qualified ACCA Accountant and Chartered Tax Adviser. Main responsibility with regard to AIT is assisting with the coordination and review of AIT's financial statements.

All members are staff spend a proportion of their time working on AIT. The volume of time varies considerably from week to week and is dependent upon things such as preparation of annual and half-year financial statements, month-end, upcoming distributions and corporate activities at an investment level.

Investment Management Agreement (IMA)

With effect from 1 January 2014, the base management fee paid to Laxey is equal to the lesser of 0.75% per annum (excluding GST) of average gross assets and $200,000. The Responsible Entity Fee and Investment Manager's Fees are capped at 1.25% per annum of average gross assets.

The IMA remains in force until the earlier of:

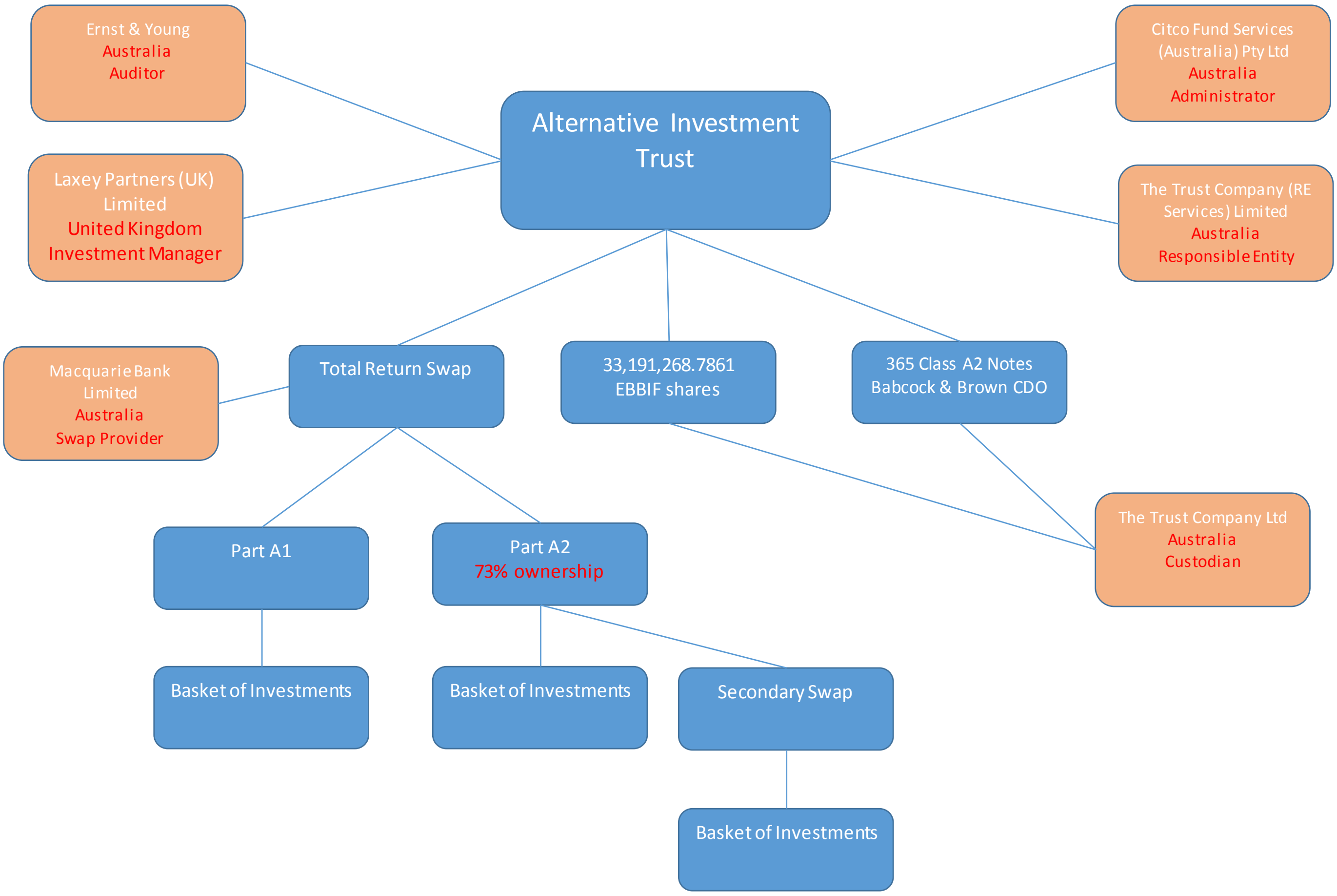
1. the date of the completion of the wind-down of AIT;
2. the Responsible Entity providing Laxey with a notice of not less than 90 days of its intention to terminate the agreement; or
3. Laxey providing the RE with a notice of not less than 6 months of its intention to terminate the agreement.

The Responsible Entity may also terminate the agreement for certain significant events such as the insolvency of Laxey or a change of control event occurring.

Disclosure Principle 3: Fund Structure

As detailed in Principles 1, 4 and 6, AIT has exposure to the majority of its underlying investments via a total return swap agreement with Macquarie Bank. In addition, it holds two assets directly, being interests in the Everest Babcock and Brown Income Fund ("EBBIF") and the Babcock and Brown CDO Fund. The swap itself has three distinct elements, firstly, a basket of investments to which AIT has 100% exposure; secondly a basket of investments to which AIT has approximately 73% exposure and finally approximately 73% exposure to a secondary swap which in turn gives AIT exposure to a basket of investments which require a US onshore investor.

Structure Diagram



The risks associated with AIT's structure and assets are disclosed under Principle 1.

Other Key Service Providers:

- AIT's direct investments and bank accounts are held by AIT's custodian, The Trust Company Ltd
- The trust's administrator is Citco Fund Services
- Link Market Services (Registry)
- Audit services are provided by Ernst & Young

Monitoring of service providers

The Responsible Entity has established a compliance plan which requires it assess any new service providers prior to their appointment and that imposes ongoing obligations on the Responsible Entity to regularly assess the performance of key service providers and their adherence with their obligations under relevant agreements established with each of these. The processes that the Responsible Entity has established to monitor service providers include:

- ongoing review of the work performed by the service providers
- compliance reporting
- annual due diligence visits
- review of internal controls reports (such as SAS 70s)

Related party relationships

Laxey and the Responsible Entity are not related entities. The Responsible Entity is a subsidiary entity of The Trust Company Limited who provides custodial services to AIT. Details of these arrangements are included in Disclosure Principle 4.

The Responsible Entity is not a related entity of Macquarie or any of the underlying Investment Managers.

Nature of arrangements

All arrangements within AIT are on normal arm's length terms.

Due diligence on underlying investment managers

On appointment as Investment Manager, Laxey conducted due diligence on all of AIT's existing underlying investments to understand AIT's rights and the funds' reporting. Laxey maintains regular contact with the managers of the underlying positions, performs further due diligence as and when required (if for example, a corporate action occurs) and monitors funds' valuations and valuation policy. Per the investment strategy, no new investments have been made or recommended by Laxey. Swap valuation (as produced by Macquarie) is also subject to monitoring.

The Investment Manager is in regular contact with the managers of the underlying investments in the Swap portfolio to understand their future plans for each position, in particular to understand when future redemptions will be made.

Underlying fees

The manager of Everest Babcock & Brown Income Fund charge management fees at a rate of 1% per annum based on the market value of units.

Disclosure Principle 4: Valuation, location and custody of assets

Valuation policy

AIT's valuation policy is discussed under Benchmark 1.

Geographic location and asset allocation policy

The Responsible Entity and Investment Manager do not have a specific policy with regard to the geographic location of AIT's assets and how those assets are to be allocated to particular asset classes. The remaining assets in the Swap were held at the time both the Responsible Entity and Investment Manager were appointed to their respective roles. The current geographical weighting and asset allocation of investments in the portfolio has been driven by redemptions from previous positions in the portfolio and is not at the discretion of either the Investment Manager or the Responsible

Entity.

<u>Custodial arrangements</u>

The major investment of AIT, being the total return swap, is held by Macquarie.

AIT's investment in the Everest Babcock and Brown Income Fund ("EBBIF") and AIT's two directly controlled bank accounts are held by The Trust Company Limited, who has been appointed as custodian for AIT's directly held investments. As noted above The Trust Company Limited is a related party of the Responsible Entity and is a custodian licensed by ASIC. The underlying swap assets are held via custodians HSBC and BNP.

The fees paid to The Trust Company Limited are based on normal arm's length terms. Under the terms of the agreement the custodian is entitled to receive a fee of 0.025% of GAV (excluding the investment in the swap) with a minimum fee of $27,000 per annum. Under the existing structure the custodian receives the minimum fee.

The Trust Company also holds AIT's investment in the Babcock and Brown CDO Fund (note this is valued at $nil and the Investment Manager does not expect AIT to receive any proceeds from it).

Disclosure Principle 5: Liquidity

The portfolio of AIT, as at June 2013, is highly illiquid. Per the realisation strategy of the trust, all underlying investments have received redemption requests; most of AIT's underlying investments have paid out proceeds according to their liquidity terms and the majority of AIT's remaining investment exposure is to side pocket positions and liquidating funds. Further details of and updates on the liquidity of AIT's exposure are released with AIT's ongoing reports – monthly factsheets, and annual and interim investment manger's reports.

Liquidating funds are those which, because of large volumes of redemption requests, were forced to close, and realise assets, distributing proceeds to investors as they become available. This dependence on the realisation of assets such as these makes distributions less certain. Laxey classifies these assets into those which make regular (but not guaranteed) distributions and those which only make ad hoc distributions as cash becomes available to them.

Side pocket positions are esoteric and extremely illiquid investments that are made by an underlying investment manager from within an underlying fund and are treated as a separate account to the main fund. When a side pocket investment is made, all current investors in the main fund receive a pro rata share of the side pocket. Investors in the fund thereafter will not have exposure to that side pocket. Similarly, once an investor redeems their main fund position, they retain their side pocket exposure (until its realisation) but they do not gain exposure to any new side pocket positions. The liquidity of a side pocket position is tied to a particular investment and as such, shareholders must wait for the manager to realise this asset before receiving cash back. The liquidity date is often highly unpredictable; these positions tend to have 2-4 year horizons on initial investment, though in practice they can take significantly longer to reach full completion. In most cases, managers will not give specific liquidity dates for positions unless they are very close to realisation. AIT's exposure to side pockets has increased during AIT's realisation process as they have been slower to liquidate than the main funds. These side pocket assets cannot be easily liquidated and they may not be redeemed at the request of the investor; as such, there is often some doubt as to the exact date of their realisation.

The risks associated with AIT's liquidity and AIT"s policy for managing liquidity are disclosed under Disclosure Principle 1.

Disclosure Principle 6: Leverage

Following:

- the unitholder meeting in 2009, where the investment strategy of AIT was changed to one of an orderly realisation; and
- the repayment of the then existing leverage facility in 2010 which was provided by Macquarie

AIT is no longer permitted to use leverage to enhance returns.

None of AIT's assets have been pledged as security.

Disclosure Principle 7: Derivatives

AIT makes use of an over the counter total return swap agreement with Macquarie Bank in order to gain exposure to the majority of its investments, the risks of which are covered under Principle 1. Other than this AIT does not make use of derivatives. There is no currency hedging in place.

Disclosure Principle 8: Short selling

Since at least 2009 the Responsible Entity has not engaged in short selling and does not intend to engage in short selling in the future.

Disclosure Principle 9: Withdrawals

<u>Current status of the scheme</u>

In accordance with section 601KA of the Corporations Act 2001, the Responsible Entity has determined that AIT is illiquid. As a result redemptions from AIT have been suspended meaning unitholders are unable to apply to the Responsible Entity to have their interests in AIT redeemed.

Based on the forecast liquidity profile of the remaining assets held in the Swap the Responsible Entity does not expect to recommence offering withdrawals/redemptions in the short to medium term.

The Responsible Entity will continue to keep unitholders appraised of changes with respect to the unfreezing of redemptions.

<u>Redemptions while AIT is illiquid</u>

Subject to certain clauses in the AIT Constitution, clause 5.7 permits the Responsible Entity to make a withdrawal offer while AIT is illiquid. Such offers can be made in a manner so determined by the Responsible Entity. In the event such an offer is made acceptances would be required to be dealt with in a manner consistent with the Corporations Act 2001 the "Act"):

The price for such an offer would be calculated after the offer is closed and any right to withdraw would need to be exercised in accordance with the Act.

At this stage the Responsible Entity does not intend to make such an offer, but will advise unitholders through an appropriate channel, if it determines it is in the best interests of unitholders to make such an offer.

Capital returns

Despite redemptions remaining frozen, returning capital to unitholders remains a key priority for the Responsible Entity. As such the Responsible Entity and Laxey continue to regularly assess AIT's available cash resources and anticipated future liquidity of the remaining assets in the Swap, with a view to ensuring that regular distributions/capital returns is made to unitholders.

Trading units on Australian Securities Exchange

Subject to the availability of buyers, unitholders wishing to sell their investment in AIT can do so by selling them via the Australian Securities Exchange.

4. Appendices

Appendix 4.1 - Periodic reporting of key information

Reporting frequency	Required disclosures
Annual (or more frequent) reporting	The responsible entity has and implements a policy to report on the following information as soon as practicable after the relevant period end: • the actual allocation to each asset type (see RG 240.73(b)); • the liquidity profile of the portfolio assets as at the end of the period—the representation of asset liquidity (the estimated time required to sell an asset at the value ascribed to that asset in the fund's most recently calculated net asset value) in a graphical or other form that allows easy comparison with the maturity profile of the liabilities; • the maturity profile of the liabilities as at the end of the period—the representation of maturities in a graphical form that allows easy comparison with the liquidity profile of the portfolio assets; • the leverage ratio (including leverage embedded in the assets of the fund, other than listed equities and bonds) as at the end of the period; • the derivative counterparties engaged (including capital protection providers); • the monthly or annual investment returns over at least a five-year period (or, if the hedge fund has not been operating for five years, the returns since its inception); and • the key service providers if they have changed since the latest report given to investors, including any change in their related party status (see RG 240.69(b)). This information must be given to members as often as, and no later than or as soon as practicable after, any periodic statement required by s1017D (but in any event no later than six months after the end of the relevant period). Note: The information required by this benchmark is in addition to any other specific information required for periodic disclosure under the Corporations Act: see RG 240.125–RG 240.126.
Ongoing availability	The latest report, which addresses the above matters, is available on the hedge fund's website.
Monthly updates	The following information is available on the hedge fund's website and is disclosed monthly or, if less often, at least as often as investors have the right to redeem their investments and in reasonable time to allow investors to consider that information in making a decision whether to redeem their investment: • the current total net asset value of the fund and the redemption value of a unit in each class of units as at the date the net asset value was calculated; Note: If the method of calculating net asset value is not disclosed with the monthly update, investors should be advised where that method is explained and how to access that information.

	• the key service providers if they have changed since the last report given to investors, including any change in their related party status; and • for each of the following matters since the last report on those matters: - the net return on the fund's assets after fees, costs and taxes; - any material change in the fund's risk profile; - any material change in the fund's strategy; and - any change in the individuals playing a key role in investment decisions for the fund.

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