

**ITEM 1  
COVER PAGE**

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**PART 2A OF FORM ADV: FIRM BROCHURE**

**BAYVIEW ASSET MANAGEMENT, LLC**

FEBRUARY 2012

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*This brochure (this "Brochure") provides information about the qualifications and business practices of Bayview Asset Management, LLC (the "Registrant"). If you have any questions about the contents of this Brochure, please contact us at (305) 854-8880 or [anshumotwani@bayviewassetmanagement.com](mailto:anshumotwani@bayviewassetmanagement.com) or [howardshoer@bayviewassetmanagement.com](mailto:howardshoer@bayviewassetmanagement.com). The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority.*

*Additional information about the Registrant also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).*

## **ITEM 2**

### **MATERIAL CHANGES**

This Brochure is the Registrant's initial Form ADV Part 2A submitted with its application for registration with the SEC, therefore, there are no material changes to report. If the Registrant makes any material changes to this Brochure, this section will be revised to include a summary of such changes.

**ITEM 3**  
**TABLE OF CONTENTS**

ITEM 1 COVER PAGE.....	i
ITEM 2 MATERIAL CHANGES .....	ii
ITEM 3 TABLE OF CONTENTS.....	iii
ITEM 4 ADVISORY BUSINESS .....	1
ITEM 5 FEES AND COMPENSATION .....	4
ITEM 6 PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT.....	7
ITEM 7 TYPES OF CLIENTS .....	8
ITEM 8 METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS.....	9
ITEM 9 DISCIPLINARY INFORMATION .....	41
ITEM 10 OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS .....	42
ITEM 11 CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING.....	47
ITEM 12 BROKERAGE PRACTICES.....	50
ITEM 13 REVIEW OF ACCOUNTS.....	52
ITEM 14 CLIENT REFERRALS AND OTHER COMPENSATION.....	53
ITEM 15 CUSTODY .....	54
ITEM 16 INVESTMENT DISCRETION .....	55
ITEM 17 VOTING CLIENT SECURITIES.....	56
ITEM 18 FINANCIAL INFORMATION .....	57

## ITEM 4 ADVISORY BUSINESS

### A. General Description of Advisory Firm

The Registrant is a Delaware limited liability company that commenced operations in 2008 and has offices in Coral Gables, Florida and New York, New York. The principal owners of the Registrant are Bayview Financial Holdings, L.P., a Delaware limited partnership ("BFH"), and Biscayne One, LLC, a Delaware limited liability company ("Biscayne One"). BFH is the managing member of, and owns a majority equity interest in, the Registrant. Biscayne One owns a minority equity interest in the Registrant. The principal owner of BFH is BFTG Holdings Company, Inc., a Florida Corporation, which is principally owned by David Ertel. David Ertel ultimately controls the Registrant through his ownership interest in Bayview Financial Management Corp., a Delaware corporation that serves as the general partner of BFH. David Ertel also controls the Registrant's affiliated general partner and investment manager entities that advise the Funds (as defined below). Biscayne One is principally owned by Blackstone RGIS Capital Partners V L.P., for which Blackstone Management Associates V USS L.L.C. serves as general partner. Blackstone Management Associates V USS L.L.C. is ultimately controlled by The Blackstone Group L.P. (NYSE: BX) (collectively with its affiliates, "Blackstone").

### B. Description of Advisory Services

The Registrant and its affiliated general partner and management company entities (together with their controlled affiliates, "Bayview") provide discretionary investment management services to private pooled investment vehicles, the securities of which are offered to investors on a private placement basis (each, a "Fund" and collectively, the "Funds"). Bayview Fund Management LLC (the "Management Company"), a Delaware limited liability company and wholly-owned subsidiary of the Registrant, serves as the management company to the Funds. The Funds include:

(i) Bayview Opportunity Domestic LP ("BOF-I Domestic"), Bayview Opportunity Offshore, L.P. ("BOF-I Offshore") and Bayview Opportunity Master Fund, L.P. (the "BOF-I Master" and together with BOF-I Domestic and BOF-I Offshore, the "BOF-I Funds"). Bayview Capital GP LLC serves as the general partner of BOF-I Domestic and BOF-I Master. Bayview Capital GP, Ltd., a Cayman Islands exempted company that is not affiliated with Bayview, serves as general partner of BOF-I Offshore and has delegated its authority to manage the affairs of BOF-I Offshore to the Management Company.

(ii) Bayview Opportunity Domestic IIa, L.P. ("BOF-IIa Domestic"), Bayview Opportunity Offshore IIa, L.P. ("BOF-IIa Offshore") and Bayview Opportunity Master Fund IIa, L.P. ("BOF-IIa Master" and together with BOF-IIa Domestic and BOF-IIa Offshore, the "BOF-IIa Funds"). Bayview Capital GP IIa, LLC serves as the general partner of BOF-IIa Domestic and BOF-IIa Master. Bayview Capital GP IIa, Ltd., a Cayman Islands exempted company that is not affiliated with Bayview, serves as general partner of BOF-IIa Offshore and has delegated its authority to manage the affairs of BOF-IIa Offshore to the Management Company.

(iii) Bayview Opportunity Master Fund IIb, L.P. ("BOF-IIb" and together with the BOF-IIa Funds, the "BOF-II Funds"). Bayview Capital GP IIb, LLC serves as the general partner of BOF-IIb.

(iv) Bayview Opportunity Domestic IIIa, L.P. ("BOF-IIIa Domestic"), Bayview Opportunity Offshore IIIa, L.P. ("BOF-IIIa Offshore") and Bayview Opportunity Master Fund IIIa, L.P. ("BOF-IIIa Master" and together with BOF-IIIa Domestic and BOF-IIIa Offshore, the "BOF-IIIa Funds" and collectively with the BOF-I Funds and the BOF-II Funds, the "BOF Funds"). Bayview Capital GP IIIa, LLC serves as the general partner of BOF-IIIa Domestic and BOF-IIIa Master. Bayview Capital GP IIIa, Ltd., a Cayman Islands exempted company that is not affiliated with Bayview, serves as general partner of BOF-IIIa Offshore and has delegated its authority to manage the affairs of BOF-IIIa Offshore to the Management Company.

(v) Bayview MSR Opportunity Domestic, L.P. ("MSR Domestic"), Bayview MSR Opportunity Offshore, L.P. ("MSR Offshore") and Bayview MSR Opportunity Master Fund, L.P. ("MSR Master" and together with MSR Domestic and MSR Offshore, the "MSR Funds"). Bayview Capital GP MSR, LLC serves as the general partner of MSR Domestic and MSR Master. Bayview Capital GP MSR, Ltd., a Cayman Islands exempted company that is not affiliated with Bayview, serves as general partner of MSR Offshore and has delegated its authority to manage the affairs of MSR Offshore to the Management Company.

(vi) Bayview Mortgage Securities Domestic, L.P., ("BMS Domestic"), Bayview Mortgage Securities Offshore, Ltd. ("BMS Offshore") and Bayview Mortgage Securities Master Fund, L.P. ("BMS Master" and together with BMS Domestic and BMS Offshore, the "BMS Funds"). Bayview Mortgage Securities GP, LLC serves as the general partner of BMS Domestic and BMS Master. The directors of BMS Offshore are not affiliated with Bayview and have delegated authority to manage the affairs of BMS Offshore to the Management Company.

As more fully set forth in Item 8 below, the BOF Funds invest primarily, although not exclusively, in residential and commercial whole loans, asset-backed securities and other credit-sensitive financial instruments. The BOF Funds generally focus on the acquisition and, through the Registrant's subsidiaries and affiliates, the management and servicing of credit-sensitive loans and real estate owned, asset-backed securities and related derivative instruments. As more fully set forth in Item 8 below, the MSR Funds invest primarily in mortgage servicing rights ("MSRs") and mortgage-related securities. As more fully set forth in Item 8 below, the BMS Funds invest primarily in asset-backed securities.

### **C. Availability of Customized Services for Individual Clients**

While the Funds may have similar and overlapping investment objectives and investment parameters, Bayview's advice with respect to the Funds is made in accordance with the investment objectives and guidelines as set forth in each Fund's constituent documents, which include any confidential private placement memorandum, organizational documents and/or investment management agreements. Bayview has the right to enter into agreements, such as side letters, with certain underlying investors of the Funds that may, in each case, provide for terms of investment that are more favorable than the terms provided to other underlying investors of the Funds.

*This Brochure generally includes information about Bayview and its relationships with its affiliates and the Funds. While much of this Brochure applies to all such affiliates and Funds, certain information included herein applies to specific affiliates or Funds only. References in this Brochure to "clients" are references to the Funds.*

**D. Wrap Fee Programs**

Not applicable.

**E. Assets Under Management**

Bayview manages approximately \$2,802,708,000 as of December 31, 2011 (or the date of this filing with respect to the BOF-IIIa Funds and the BMS Funds) on a discretionary basis. This figure represents the unaudited net asset value of the BOF-I Funds, the BOF-II Funds and the MSR Funds as of December 31, 2011 plus any uncalled capital commitments for BOF-IIb and the MSR Funds, which are still in their investment period as of the date of this filing. This amount also includes total capital commitments to the BOF-IIIa Funds and total subscriptions of the BMS Funds as of the date of this filing, as each such Fund launched subsequent to December 31, 2011. As of December 31, 2011, Bayview manages no assets on a non-discretionary basis.

## **ITEM 5**

### **FEES AND COMPENSATION**

#### **A. Fees and Compensation**

##### Management Fee

Generally, the Funds pay the Management Company a fee for investment management services (the "Management Fee") for each fiscal quarter ranging from 0.25% (1.00% per annum) to 0.5% (2.0% per annum) of the beginning net asset value of each investor's capital account for such fiscal quarter.

The Management Fee is calculated and paid in advance but is amortized monthly by each Fund over the quarter for which such Management Fee is paid. The Management Fee generally will be prorated for any capital contribution or withdrawal by an investor that is effective other than as of the first day of a quarter. In the event of a withdrawal by an investor other than as of the last day of quarter, the Management Company will repay to the Fund a pro rata portion of the Management Fee, based on the actual number of days remaining in such quarter.

In the sole discretion of the Management Company, the Management Fee may be waived, reduced or calculated differently with respect to certain investors.

##### Incentive Allocation

The general partner of the Funds generally will receive an annual performance-based allocation (an "Incentive Allocation") of a portion of the net capital appreciation allocated to each investor's capital account, as more fully described below.

Generally, at the end of each calendar year of each of the Funds (other than the BMS Funds), net capital appreciation, if any, allocated to an investor's capital account in such Fund will generally be reallocated in the following order of priority (as more fully described in such Fund's constituent documents): (i) first, to the investor until the investor has made up previous losses; (ii) second, to the investor until it has achieved a hurdle rate of return; (iii) third, to the general partner and the investor pursuant to a catch-up allocation until the general partner has received 20% of such net capital appreciation for such year; (iv) fourth, an 80/20 split between the investor and the general partner, respectively, until the return equals a threshold amount; and (v) fifth, a 70/30 split between the investor and the general partner, respectively.

Generally, at the end of each calendar year of the BMS Funds, net capital appreciation, if any, allocated to an investor's capital account will be reallocated in the following order of priority: (i) first, to the investor until the investor has made up previous losses; and (ii) second, a 90/10 split between the investor and the general partner, respectively.

In the sole discretion of the relevant general partner, the Incentive Allocation may be waived, reduced or calculated differently with respect to certain investors.

## **B. Payment of Fees**

Fees and compensation paid or allocated to the Management Company and the general partners by the Funds are generally deducted from the assets of such Funds (or reallocated from the investors' capital accounts to the general partners' capital accounts) at the times and in the manner discussed above.

## **C. Additional Fees and Expenses**

To the extent permitted under the relevant Funds' constituent documents, each Fund bears all of its (and, as applicable, a pro rata share of any such Fund's corresponding master fund's) legal and other organizational expenses incurred in the formation of such Fund, including all expenses relating to the offer and sale of interests in such Fund; *provided* that legal and other organizational expenses (other than the fees payable to any placement agent for the interests in such Fund, which will be paid by the Management Company either directly or indirectly by offsetting management fees owed to the Management Company as provided below) borne by such Fund may be subject to a cap. Bayview (and not the relevant Fund) bears any such legal and other organizational expenses in excess of any such cap. The Funds bear their operating and other expenses including, but not limited to, investment-related expenses (*e.g.*, costs, fees and other out-of-pocket expenses directly related to (i) the investigation of investment opportunities (whether or not consummated) and research-related expenses, including, without limitation, news and quotation equipment and services, market data services, and fees to third-party providers of research and/or portfolio risk management services and (ii) the negotiation, acquisition, settlement, ownership, financing, hedging or sale of its investments and other transaction costs, including travel expenses, transaction fees, consulting, advisory, investment banking, legal and other professional fees relating to investments or contemplated investments, brokerage commissions, information-related expenses, clearing and settlement charges, custodial fees, interest expenses, appraisal fees and expenses), legal, auditing and accounting expenses (including expenses associated with the preparation of Fund financial statements, tax returns and schedules K-1), expenses incurred in collection of monies owed to the Fund, insurance expenses (including, without limitation, directors' and officers' insurance, errors and omissions insurance and other similar policies), printing and mailing costs, placement fees payable by such Fund in connection with the offering of interests therein (which placement fees will offset management fees dollar for dollar), expenses relating to meetings of the advisory board, regulatory expenses (including filing fees), the costs and expenses of third-party risk management products and services (including, without limitation, the costs of risk management software or database packages), and to the extent applicable, any entity-level taxes, fees or other governmental charges levied against the Fund, wind-up and liquidation expenses, extraordinary expenses (such as litigation-related and indemnification expenses) and expenses comparable to the foregoing.

In addition, the MSR Funds also bear expenses associated with any swap transactions to give the MSR Funds economic exposure to the MSRs owned by Lakeview Loan Servicing, an indirect wholly-owned subsidiary of the MSR Funds ("Lakeview"), and the salary and benefits of Lakeview's employees. The MSR Funds also bear the expenses of entities controlled directly or indirectly by the MSR Funds or that are under common control with the MSR Funds, in each case that have been organized to carry out the business principally of and for the benefit of the MSR Funds (including, without limitation, Lakeview) (each, a "Controlled Affiliate").



See Item 12 for further discussion with respect to fees associated with brokerage practices.

Certain Funds will also pay fees to Bayview for (i) sourcing investment opportunities, underwriting and managing the purchase process for certain of the Funds' investments (such fees the "Acquisition Fees"); (ii) servicing certain of the loans in such Funds' portfolios (such fees the "Servicing Fees"); and (iii) with respect to the MSR Funds and other Funds, providing loss mitigation services and foreclosure management services to subservicers with respect to mortgage loans underlying the MSR Funds' MSRs or loans owned by Funds (such fees, the "Component Fees").

Bayview Loan Servicing, LLC, a subsidiary of the Registrant ("BLS"), may originate a new loan to a borrower to refinance an existing loan owned by certain Funds or may accomplish modifications that result in a new loan. In connection with any such refinancing, BLS may charge certain Funds a fee based on the amount of such new or modified loan (the "Refinancing Fee"). If BLS facilitates the origination of a new loan by a third party in connection with a refinancing of an existing loan owned by certain Funds, BLS may charge such Funds an additional fee based on the amount of such new or modified loan (the "Facilitation Fee").

The Acquisition Fees, Servicing Fees, Component Fees, Refinancing Fees and Facilitation Fees are described more fully in the confidential private placement memoranda of the Funds to which such fees apply.

#### **D. Prepayment of Fees**

Please see response to Items 5A and 5B above.

#### **E. Additional Compensation and Conflicts of Interest**

As discussed above, Bayview receives the fees discussed above in Item 5C in connection with sourcing investment opportunities, underwriting and managing the purchase process for certain Funds' investments. Bayview may also receives a due diligence fee from certain Funds for every loan reviewed for such Funds, which includes underwriting, appraisal review, title review and transaction management. In addition, Bayview may receive a closing fee from certain Funds for every loan closed on behalf of such Funds. Certain of these fees give rise to a conflict of interest and may create an incentive for Bayview to make investments on behalf of certain Funds based on the compensation received by Bayview, rather than the Funds' needs. In order to mitigate the conflicts involved with these transactions, Bayview has and agreed to a fee schedule in the relevant Funds' confidential private placement memoranda.

## **ITEM 6**

### **PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT**

As noted in Item 5, Bayview receives performance-based compensation from the Funds. Clients should be aware that performance-based compensation may be deemed to create a conflict of interest for Bayview, as there can be an incentive for Bayview to make investments that are riskier or more speculative than would be the case in the absence of performance compensation. In addition, in situations where certain Funds will pay smaller performance compensation (due to the existence of a loss carryforward, a higher preferred return, different compensation rates and structures or otherwise), there can be an incentive for Bayview to favor those Funds that pay higher performance compensation, for example, by allocating more opportunities to such Funds. To seek to mitigate this inherent conflict of interest, Bayview has implemented allocation policies and procedures (discussed more fully in Item 11D) that seek to ensure that investments are allocated among the Funds on what Bayview deems to be an equitable basis.

**ITEM 7**  
**TYPES OF CLIENTS**

Bayview provides investment advice to the Funds, as described above in Item 4. The constituent documents for each Fund set minimum amounts for investment by prospective investors. Bayview may modify or waive such minimum investment requirements from time to time.

## **ITEM 8**

### **METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS**

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

##### The BOF Funds

Bayview's investment strategy with respect to the BOF Funds involves investing primarily, although not exclusively, in residential and commercial whole loans, mortgage-backed securities and other credit-sensitive financial instruments. While there are no material limitations on the assets in which the BOF Funds may invest, the BOF Funds generally focus on the acquisition and, through the Registrant's subsidiaries and affiliates, the management and servicing of the assets that are eligible for investment, which include, without limitation, residential and commercial mortgages; consumer performing, non-performing and re-performing whole loans; interest-only securities and inverse interest-only securities; real estate owned ("REO"); non-agency mortgage and asset-backed securities; mortgage-related credit and real estate derivatives; equity, debt or options in mortgage-related companies; and other industry similar assets, including loans and other assets secured by U.S. and non-U.S. collateral. The BOF Funds may also take long and short proprietary positions in corporate securities, credit derivatives and indices, either for investment or to hedge the BOF Funds' loan strategies and cash and other synthetic positions.

While the specific investment opportunities available to the BOF Funds may change over time as supply/demand dynamics in the market and the origination industry evolve, Bayview generally focuses on a wide range of opportunities and strategies within the mortgage credit sector and seeks to capitalize on its expertise in loan modifications and proprietary models to analyze underlying collateral in combination with active servicing through its affiliated servicer, BLS, to engage in loss mitigation.

In pursuing the BOF Funds' investment strategies, Bayview will seek to invest in assets that can be acquired at what it believes to be significant discounts to their principal economic value due to credit impairment, liquidity or other factors. Bayview's underwriting and diligence team conducts an extensive review of opportunities and follows a disciplined underwriting approach. Bayview's diligence practices include loan-level real estate reviews and borrower credit diligence, legal diligence, thorough fraud checks, lien searches, review of payment histories, expeditious recording of assignments and mortgages and other components of risk management. Additionally, Bayview's valuation team of licensed in-house appraisers seek to evaluate market value in combination with traders who seek to leverage internally developed research and analytics to make pricing and portfolio management decisions. Bayview's loss mitigation team is trained to assess each borrower's individual circumstance in an attempt to maximize the value of each loan, including rate/term modifications, forbearance plans, deeds-in-lieu of foreclosure, shortfall payoffs and, if necessary, foreclosure and REO liquidation.

##### The MSR Funds

Bayview's investment strategy with respect to the MSR Funds is to seek to generate attractive risk-adjusted returns by generating current income and capital appreciation through investments in MSRs. While the MSR Funds focus primarily on investing in MSRs, the

MSR Funds may also invest in a range of additional opportunities that exist within the mortgage credit sector both for short or intermediate term investment and for hedging purposes; such assets include interest-only securities and inverse interest-only securities, agency and non-agency mortgage-backed securities, and mortgage-related credit, interest-only, and real estate derivatives, and equity securities of mortgage-related companies.

In pursuing this investment strategy, the MSR Funds (or a Controlled Affiliate thereof) generally seek to generate positive cash flow by engaging a subservicer to perform the primary servicing functions at a cost that is less than the servicing fees the MSR Funds are entitled to as owner of the MSRs. In evaluating whether a particular pool of MSRs is appropriate to purchase, Bayview will consider numerous factors, including, without limitation: (i) potential for risk-adjusted returns based on the contemplated purchase price and asset structure; (ii) characteristics of the underlying mortgage loans; (iii) terms and conditions imposed by the pooling and servicing agreements; and (iv) availability of a highly qualified subservicer on favorable economic terms.

#### The BMS Funds

Bayview's investment strategy with respect to the BMS Funds is to generate risk-adjusted returns by investing primarily in secondary market asset-backed securities and related financial instruments.

#### All Funds

Subject to any limitations in a particular Funds' constituent documents, Bayview is authorized to invest in all types of securities, other financial instruments and assets of issuers and counterparties located in any region of the world. The securities, instruments and other assets in which one or more of the Funds may invest include, but are not limited to, (a) debt or equity securities of any issuer, including capital stock; shares of beneficial interest; partnership interests and similar financial instruments; loans (including, without limitation, residential, commercial and consumer performing, non-performing and re-performing whole loans, interest-only securities and inverse interest-only securities and REO) and loan participations; structured products; bond, notes and debentures (whether subordinated, convertible or otherwise); currencies; interest rate, currency, commodity, equity and other derivative products including, without limitation: (i) futures contracts (and options thereon) relating to stock indices, currencies, commodities, U.S. Government securities and securities of foreign governments and other financial instruments; (ii) swaps, options, puts, calls, warrants, debt securities, caps, collars, floors and forward rate agreements; (iii) spot and forward currency transactions; and (iv) agreements relating to or securing such transactions; real estate securities; mortgage-backed obligations, including, if issued or collateralized by Federal agencies (including, without limitation, fixed-rate pass-throughs, adjustable rate mortgages, collateralized mortgage obligations and stripped mortgage-backed securities); MSRs; equipment lease certificates; equipment trust certificates; credit paper; accounts and notes receivable and payable held by trade or other creditors; trade acceptances; choses in action; contract and any other claims; executory contracts; participations; mutual funds; money market funds; obligations of the United States or any state thereof, foreign governments and instrumentalities of any of them; commercial paper certificates of deposit; banker's acceptances; trust receipts; and other obligations and instruments or evidences of indebtedness of whatever kind or nature; in each case, of any person, corporation, government or other entity whatsoever, whether or not publicly traded or readily marketable

and (b) real and personal property, including, without limitation, office, retail, industrial, hotel, residential, recreational, health care or mixed-use assets or land.

*The descriptions set forth in this Brochure of specific advisory services that Bayview offers to clients, and investment strategies pursued and investments made by Bayview on behalf of its clients, should not be understood to limit in any way Bayview's investment activities. Bayview may offer any advisory services, engage in any investment strategy and make any investment, including any not described in this Brochure, that Bayview considers appropriate, subject to each Fund's investment objectives and guidelines. There can be no assurance that the investment objectives of any Fund will be achieved.*

## **B. Certain Risks Relating to Investment Strategies**

The investment programs for each of the Funds involve a substantial degree of risk and such activities could result in a substantial loss of capital. The following risk factors do not purport to be a complete list or explanation of the risks involved with the activities of Bayview and the Funds. These risk factors include only risks Bayview believes to be material, significant or unusual based on information currently available, and relate to particular investment strategies employed by Bayview and investments made pursuant thereto, and do not address material, significant or unusual risks associated with other factors, including, without limitation certain instrument types, structural risks and certain market risks.

### Overall Investment Strategy and Investment Risks

*Risks of Investments Generally.* All investments risk the loss of capital. No guarantee or representation is made that the Funds' investment programs will be successful. The Funds' investment programs involve, without limitation, risks associated with limited diversification and concentration, leverage, investments in speculative assets and the use of speculative investment strategies and techniques, interest rates, currencies, volatility, tracking risks in hedged positions, credit deterioration or default or prepayment risks, systems risks and other risks inherent in the Funds' and any Controlled Affiliates' activities. Certain investment techniques of the Funds (e.g., use of direct leverage or indirectly through leveraged investments) can, in certain circumstances, magnify the impact of adverse market moves to which the Funds may be subject. In addition, the Funds' investments may be materially affected by conditions in real estate markets, the financial markets and overall economic conditions occurring globally and in particular countries or markets where the Funds and any Controlled Affiliates may invest their assets.

The Funds' methods of minimizing such risks may not accurately predict future risk exposures. Risk management techniques are based in part on the observation of historical market behavior, which may not predict market divergences that are larger than historical indicators. Also, information used to manage risks may not be accurate, complete or current, and such information may be misinterpreted.

*Limited Diversification.* In the normal course of making investments on behalf of the Funds, Bayview will be concentrated within the mortgage credit sector and in MSRs. In addition, in some Funds, it is possible that Bayview may select investments that are concentrated in a limited number or type of financial instruments or assets. Such concentration of risk may increase the losses suffered by the Funds or reduce their ability to hedge their exposure and to

dispose of depreciating assets. Limited diversity could expose the Funds to losses disproportionate to market movements in general if there are disproportionately greater adverse price movements in those financial instruments or assets. In the Funds that are concentrated in a limited number or type of financial instruments (such as MSRs), the overall adverse impact on the Funds of adverse movements in the value of their portfolios will be considerably greater than if the Funds were not permitted to concentrate their investments in such manner.

*Leverage.* The Funds intend to lever their assets through various types of financings, including seller financing, and through various securitization vehicles. Bayview may also cause the Funds to leverage their investment returns with options, short sales, swaps, forwards and other derivative instruments.

While leverage presents opportunities for increasing the Funds' total returns, it has the effect of potentially increasing losses as well. Accordingly, any event that adversely affects the value of an investment by the Funds would be magnified to the extent the Funds are leveraged. The cumulative effect of the use of leverage by the Funds in a market that moves adversely to the Funds' investments could result in a substantial loss to the Funds, which would be greater than if the Funds were not leveraged. Leverage will increase the exposure of the Funds to adverse economic factors such as significantly rising interest rates, severe economic downturns or a deterioration in the condition of the Funds' investments or their corresponding markets.

The Funds may engage in portfolio financings where several investments are cross-collateralized, pursuant to which multiple investments may be subject to the risk of loss. As a result, the Funds could lose their interests in performing investments in the event such investments are cross-collateralized with poorly performing or non-performing investments. In addition, recourse debt, which the Funds reserve the right to obtain, may subject other assets of the Funds' investments to risk of loss.

*Illiquidity.* A substantial portion of the Funds' portfolios may consist of loans, MSRs or other financial instruments that are not actively or widely traded. Mortgage/real-estate-backed loans and asset-backed securities are generally less liquid than are other securities (*e.g.*, stocks or bonds). Consequently, it may be relatively difficult for the Funds to dispose of such investments rapidly and at favorable prices in connection with withdrawal requests, adverse market developments or other factors. Illiquid assets may also be more difficult to value.

*General Economic and Market Conditions.* The success of the Funds' activities will be affected by general economic and market conditions, such as interest rates, availability of credit, inflation rates, economic uncertainty, changes in laws (including laws relating to taxation of the Funds' investments), trade barriers, currency exchange controls and national and international political circumstances (including wars, terrorist acts or security operations). These factors may affect the level and volatility of securities prices and the liquidity of the Funds' investments. Volatility or illiquidity could impair the Funds' profitability or result in losses.

The economies of non-U.S. countries may differ favorably or unfavorably from the U.S. economy in such respects as growth of gross domestic product, rate of inflation, currency depreciation, asset reinvestment, resource self-sufficiency and balance of payments position. Further, certain non-U.S. economies are heavily dependent upon international trade and,

accordingly, have been and may continue to be adversely affected by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. The economies of certain non-U.S. countries may be based, predominantly, on only a few industries and may be vulnerable to changes in trade conditions and may have higher levels of debt or inflation. The effects of rapid and significant changes in economic conditions, severely limited availability of credit, increased volatility of financial markets and other factors are difficult to predict.

#### Risks Related to the U.S. Residential Mortgage Market, Residential Mortgage-Backed Securities, MSRs and Servicers

*Conditions in the U.S. Residential Mortgage Market May Adversely Affect the Performance of the Funds.* The Funds intend to invest in assets related to the U.S. residential mortgage market, including in subprime mortgage loans, securities backed directly or indirectly by subprime mortgage loans and MSRs of subprime mortgage loans and securities backed directly or indirectly by subprime mortgage loans. Over the past several years, the residential mortgage market in the United States has experienced a variety of difficulties and changed economic conditions that may adversely affect the performance of the Funds. The performance of residential mortgage loans is influenced by a wide variety of economic, geographic, social and other factors, including general economic conditions, the level of prevailing interest rates, the availability of alternative financing and homeowner behavior. Since mid-2007, the mortgage market has encountered difficulties that may adversely affect the performance of the Funds.

In recent years, delinquencies, defaults and foreclosures on residential mortgage loans have increased, and they may continue to increase in the future. The increase in delinquencies, defaults and foreclosures has significantly affected (although it has not been limited to) "subprime" mortgage loans, which generally refers to loans made to borrowers with impaired credit, and has also affected "Alt-A" mortgage loans, which generally refers to loans made to borrowers with good credit but for which limited documentation or no documentation of borrower income and/or assets was required in connection with their loan application, and even "prime" mortgage loans, which generally refers to loans made to borrowers with excellent credit who provide full documentation. As the Funds may invest in one or more of these types of loans, securities backed by one or more of these types of loans, or MSRs for one or more of these types of loans, the performance of the Funds may be sensitive to the same economic factors that affect these types of loans.

General trends in consumer borrowing and mortgage lending over the past decade may have increased the sensitivity of the mortgage market to changes in economic conditions. Many mortgage lenders loosened their credit criteria, including by increasing lending to first time homebuyers and borrowers with lower credit scores, by making loans made with low or no document income verification or without regard to ability to pay (including after a rate reset), and by making loans with higher loan-to-value ratios. In addition, certain borrowers may have financed their equity contributions with "piggy-back" junior lien loans, resulting in little to no equity contributed by the borrower with respect to their mortgage loan financing. As property values generally increased, consumers borrowed against the increasing equity in their homes to cover other expenses, such as investments in home remodeling and education costs, resulting in an increase in debt service as a percentage of income. Increasing property values also encouraged borrowers to obtain mortgage loans to finance investment properties, which generally have a higher tendency to become delinquent and to default than mortgage



loans made to finance primary residences. In connection with the origination of low or no documentation loans, lenders may have been willing to make such loans by relying primarily on the value or expected value of the property rather than on the creditworthiness of the borrower. These trends in the mortgage loan industry and in consumer behavior have increased the likelihood of defaults, delinquencies, foreclosures and losses on mortgage loan portfolios.

In addition to higher delinquency, default and foreclosure rates, loss severities on all types of residential mortgage loans have increased due to declines in residential real estate values, resulting in reduced home equity. Home price appreciation rates have generally been negative for several years, and this trend may continue for an indefinite period of time. Higher loan-to-value ratios and combined loan-to-value ratios generally result in lower recoveries on foreclosure, and an increase in loss severities above those that would have been realized had property values remained the same or continued to increase.

Current market conditions may impair borrowers' ability to refinance or sell their residential properties, which may contribute to higher delinquency and default rates. In response to increased delinquencies and losses with respect to mortgage loans, many originators have implemented more conservative underwriting criteria for mortgage loans, which has resulted in reduced availability of refinancing alternatives for borrowers. These risks would be exacerbated to the extent that prevailing mortgage interest rates increase from current levels. Home price depreciation experienced to date, and any further price depreciation, may also leave borrowers with insufficient equity in their homes to permit them to refinance. While some lenders and servicers have created modification programs in order to assist borrowers with refinancing or otherwise meeting their payment obligations, not all borrowers have qualified for or taken advantage of these opportunities.

Recessive economic trends in the United States continue to be primary indicators of defaults and delinquencies. Continued unfavorable economic conditions could increase the likelihood of delinquencies and defaults. A general unavailability of credit also affects the overall economy in ways that result in increased delinquencies and defaults on residential mortgage loans, which may also affect MSRs related to such mortgage loans.

Another factor that has contributed to, and may in the future result in, higher delinquency rates is the increase in monthly payments on adjustable-rate mortgage loans ("ARMs") and/or pay option ARMs, which permit a borrower, for a limited period of time, to elect to make a monthly payment that may be insufficient to pay the full amount of interest due on the loan. Under a pay option ARM, accrued interest that is not paid is added to the principal balance of the loan. At the end of the payment option period, the monthly payment amount is recast to an amount sufficient to pay accrued interest and to amortize the outstanding principal balance over the remaining term of the loan, which may be substantially higher than the prior monthly payment amount.

Borrowers with adjustable payment mortgage loans are being exposed to increased monthly payments when the related mortgage interest rate adjusts upward from the initial fixed rate or a low introductory rate, as applicable, to the rate computed in accordance with the applicable index and margin. Borrowers with pay option ARMs are exposed to even greater increases in monthly payments due to the negative amortization of the principal balances of their loans. These increases in borrowers' monthly payments, together with any increase in prevailing market interest rates, may result in significantly increased monthly payments for borrowers

with ARM loans. Borrowers seeking to avoid these increased monthly payments by refinancing their mortgage loans may no longer be able to find available replacement loans at comparably low interest rates, if at all. A further decline in housing prices may also leave borrowers with insufficient equity in their homes to permit them to refinance, and in addition, many mortgage loans have prepayment premiums that inhibit refinancing. Many borrowers who might otherwise qualify for refinancing have been unable to obtain new loans due to conditions in the credit markets. Furthermore, borrowers who intend to sell their homes on or before the expiration of the fixed-rate periods on their mortgage loans may find that they cannot sell their properties for an amount equal to or greater than the unpaid principal balance of their loans, or that prospective buyers of their homes are unable to obtain financing. These events, alone or in combination, may contribute to higher mortgage loan delinquency rates or defaults. These events may also affect the mortgages underlying residential mortgage-backed securities ("RMBS") and MSR with respect to such mortgages, which could result in losses to the Funds.

Any further deterioration of the U.S. residential mortgage market could result in increased delinquencies or defaults on the mortgage loans underlying the MSRs held by the MSR Funds. An increase in delinquencies and defaults would reduce servicing fee revenue and increase servicing expenses. During any period in which the borrower is not making payments on a mortgage loan, Lakeview may be required under substantially all of the pooling and servicing agreements relating to its MSRs to advance cash to meet contractual principal and interest remittance requirements for the securitization trust or entity that owns the mortgage loans, pay property taxes and insurance premiums and potentially process foreclosures. Lakeview may also be required to advance funds to maintain, repair and market foreclosed real estate properties. In addition, defaults on mortgage loans will reduce the number of loans that Lakeview and the subservicers are servicing, resulting in a decrease in the value of the associated MSRs. Further, pooling and servicing agreements may contain servicer termination events or events of default for the servicer based upon the number of delinquent loans or the loss performance of the related mortgage loans, some of which may have been triggered prior to the acquisition of the related MSRs. While the parties to the securitization transactions may not have enforced their remedies at the time of acquisition, they could enforce them in the future, which could result in losses to investors. If Lakeview is terminated as servicer with respect to a pooling and servicing agreement, such termination may negatively impact some of the MSR Funds' operating results and may make it more difficult to acquire additional MSRs in the future.

*Regulation of the Mortgage Industry and the Dodd-Frank Act.* There have been various adverse developments in the financial markets, which have resulted in the merger and failure of several major investment banks and commercial banks. In response to such developments, the United States government implemented certain programs intended to stabilize its financial system, including sweeping financial and regulatory reform legislation. These developments have heightened an overall level of uncertainty in the securitization market and the financial markets, generally, particularly with respect to mortgage-related investments. For example, the Dodd-Frank Act includes several provisions that have already had, and will continue to have, a significant impact on securitization practices; however, various related regulatory initiatives have not been fully implemented and several requirements of the legislation have not been finalized. Accordingly, the complete impact of such recent government action is not yet known. The Dodd-Frank Act includes significant changes to the regulation of financial institutions as well as enhanced regulation of derivatives and mortgage-backed securities offerings and the elimination of prepayment penalties for mortgage loans and expanded

consumer protection in respect of high-cost loans. The Dodd-Frank Act also clarifies that assignees of mortgage loans will be subject to assignee liability for high cost loan violations and for any failure of an originator to correctly determine a borrower's ability to repay the related mortgage loan. In many cases the provisions of the statute will take effect only after regulations are adopted by the applicable Federal agencies.

Securities, futures and credit markets and servicers of residential mortgage loans, including any subservicers that Controlled Affiliates may engage are subject to comprehensive statutes and extensive regulation by federal, state and local governmental authorities. Servicers are also subject to supervision, audit and examination and enforcement by the state agencies that license servicing and collection activities, as well as the Consumer Financial Protection Bureau (the "CFPB").

It is not clear what the final form of any implementing regulations will be, how they will be implemented, or whether the Funds will be affected. No assurance can be given that the new standards will not have an adverse impact on the Funds, BLS or any other servicer servicing residential mortgage loans on behalf of the Funds or underlying any residential mortgage-backed securities held by the Funds.

The conservatorship of Fannie Mae and Freddie Mac and the current uncertainty regarding the future status of these organizations may adversely affect the real estate market and the value of real estate assets generally. It remains unclear to what extent the ability of Fannie Mae and Freddie Mac to act as the primary sources of liquidity in the residential mortgage markets, both by purchasing mortgage loans for portfolio and by guaranteeing mortgage-backed securities, may be curtailed.

The U.S. Treasury Department, several regulatory bodies and state attorneys general have recently increased scrutiny of mortgage servicers and have imposed, or are seeking to impose, requirements on servicers to substantially revise their servicing practices, including proposals to establish a national servicing standard that would be applicable to all residential mortgage servicers. It is unclear what effect, if any, these changes will have on the performance of mortgage loan servicing generally, or on the performance of any mortgage loans (or RMBS backed by such loans) that are held by the Funds and serviced by such mortgage loan servicers. These laws, regulations and rules may result in delays in the foreclosure process, reduced payments by borrowers or increased reimbursable servicing expenses, which could result in delays and reductions in the distributions to the Funds in respect of residential mortgage loans owned by the Funds from time to time. The Funds will bear the risk that such regulatory developments will result in losses, whether due to delayed or reduced distributions or reduced market value.

Actions that have been taken and may be taken in the future by the U.S. government or by state or municipal governments may have the effect of encouraging, or may require, that the terms of residential mortgage loans be modified in order to reduce the applicable interest rate, reduce the outstanding principal amount, extend the term to maturity or otherwise benefit the borrower to the detriment of the holder of the mortgage loan and the owner of the MSRs. These loan modifications may affect only residential mortgage loans that are in default or may also affect other loans as to which the borrower has negative equity in the mortgaged property or is otherwise considered to be disadvantaged or deserving of assistance. Investments held by the Funds could be adversely affected, resulting in decreased yield or losses to investors. With regard to the MSR Funds, while certain loan modifications may be

beneficial to the owner of MSRs (*e.g.*, in the case of certain non-performing agency mortgage loans where owners of the MSRs may not be entitled to servicing fees or modifications in lieu of foreclosure), modifications that facilitate prepayment or reduce principal and interest can have an adverse effect on Lakeview's net cash flows from servicing fees and result in losses to the MSR Funds. Similarly, programs designed to facilitate refinancings by current borrowers who would not otherwise qualify also could have such an adverse effect.

The Dodd-Frank Act also contains the Mortgage Reform and Anti-Predatory Lending Act (the "Mortgage Act"). The Mortgage Act imposes a number of additional requirements on servicers of residential mortgage loans by amending certain existing provisions and may prevent servicers of residential mortgage loans from taking certain actions that could lead to increased servicing costs.

Lakeview and the subservicers may incur significant ongoing costs to comply with new and existing laws and governmental regulation of their residential mortgage servicing businesses. Further, if any new or more restrictive requirements increase the cost of servicing mortgage loans, then the subservicing fees subservicers will require are likely to increase, which could limit Lakeview's ability to purchase MSRs if it cannot engage subservicers at servicing fee rates that are consistent with the MSR Funds' investment objectives.

On May 20, 2009, President Barack Obama signed S. 896 into law the "Helping Families Save Their Homes Act of 2009" (the "HFSTH"). Among other provisions, the law provides a safe harbor within which servicers may modify and/or refinance mortgage loans and engage in other loss mitigation activities with limited to no liability to investors and other parties for any resulting failure to maximize the net present value of the mortgages that they service. On March 4, 2009, the U.S. Treasury announced the Obama Administration's Home Affordable Modification Program ("HAMP"), which provides a detailed, uniform model for the one-time modification of eligible residential mortgage loans in default or imminent default. HAMP provides for the payment by Fannie Mae, on behalf of the U.S. Treasury, of incentive fees to servicers and investors related to successful modifications. To be eligible for such incentives, the servicer must execute a "Servicer Participation Agreement" with Fannie Mae, as agent for the U.S. Treasury. BLS has executed such Servicer Participation Agreement. Accordingly, the BAM Agreements (as defined below in Item 10) require that the portion of mortgage loans that are subject to HAMP be serviced in accordance with HAMP guidelines instead of BLS's previous loss mitigation standards, and, as a result, such investments might not be as beneficial as otherwise expected.

The U.S. Treasury also announced Obama Administration's Home Affordable Refinance Program ("HARP"), which provides refinance opportunities to current borrowers with mortgages either held by or backing securities guaranteed by Fannie Mae or Freddie Mac. If there is a material increase in refinancings under HARP as a result of these changes, the rate of prepayments of loans underlying the MSR Funds' MSRs could increase materially and beyond the estimated prepayment speeds on which the value of such MSRs was based in part. Such prepayments would reduce the amount of servicing fees collected by Bayview and could result in an adverse effect on Bayview's or its Controlled Affiliates' net cash flows, which could result in losses to the MSR Funds.

There can be no assurance that these or other recent U.S. government actions will have a beneficial impact on the financial markets. To the extent the market does not respond favorably to these initiatives or these initiatives do not function as intended, the Funds may

not receive the anticipated positive impact from the legislation. In addition, because the programs are designed, in part, to provide liquidity to restart the market for certain of the Funds' targeted assets, the establishment of these programs may result in increased competition for attractive opportunities in certain investments. It is also possible that competitors may utilize the programs which would provide them with attractive debt and equity capital funding from the U.S. government. In addition, the U.S. government, the Federal Reserve, the U.S. Treasury and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. Bayview cannot predict whether or when such actions may occur, and such actions could have a dramatic impact on the business, results of operations and financial condition of the Funds.

*Sources of Income Related to MSRs.* Income related to MSRs is generated principally from three sources. Depending upon the servicing agreement applicable to the MSRs and the agreements that can be negotiated with subservicers, either the servicer or subservicer may be entitled to additional sources of servicing income. First, servicers are entitled to standard minimum servicing fees, which fees are based on a specified percentage of the mortgagor's interest payments actually collected by the servicer. This fee is payable on a monthly basis, by the servicer retaining a portion of the interest payment collected from the borrower as its servicing fee and forwarding the remainder to the mortgage investor. In most cases, the investor or guarantor on whose behalf the loans are being serviced has no contractual obligation to pay the servicing fee to the servicer. Rather, the fee is contingent entirely on the ability of the servicer to collect either the borrower's monthly payment or sufficient liquidation or insurance proceeds.

The scheduled amortization of principal payments on the loans will cause a corresponding reduction in the amount of the aggregate servicing fees. This is referred to as the "run-off." Similarly, full or partial prepayment of a mortgage loan results in a termination of the servicing fee with respect to the prepaid balance of that mortgage loan. This means that the perceived likelihood of prepayment is a significant factor in valuing servicing.

A second source of servicing income is fees and charges imposed on the borrower, generally by the servicer, such as late charges, assumption fees and other fees relating to the performance of specific servicing tasks either at the request of the borrower or as a result of a borrower action or omission to act. These fees may be limited by applicable state and federal law, the mortgage loan documents, the terms of the servicing agreements or the applicable servicing guides.

Third, servicers can generate interest earnings, or "float," on their maintenance of the principal and interest account and the escrow accounts between the time of the collection of payments by or on behalf of borrowers and the time of application of such funds. Many states, however, require servicers to pay interest to borrowers on their escrow accounts at a specified rate.

*Risks Associated with Approvals and Licensing of Mortgage Loan Servicers related to the MSR Funds.* Lakeview and the subservicers are also subject to licensing requirements as owners of MSRs. If the number of states that require the licensing of owners of MSRs increases, or the states that require licensing impose additional obligations on the owners of MSRs, Lakeview's costs could increase. Any of these outcomes may adversely affect Lakeview's or any subservicer's operations or financial conditions and result in losses to the Funds.

*Subservicer and Termination Risk related to MSRs.* None of the MSR Funds, Lakeview or any Controlled Affiliates will perform any servicing function or have the capacity to service MSRs. Lakeview expects it will customarily enter into subservicing agreements with subservicers which will undertake to subservice the mortgage loans for Lakeview and the MSR Funds for a specified term (e.g., 2 or 5 years). The subservicers will be responsible for satisfying most of the legal requirements and agency and loan owner's guidelines that relate to the activities of collecting on, and enforcing the terms of, mortgage loans. Nevertheless, as Lakeview will be contractually obligated to service the underlying mortgage loans, Lakeview will have the ultimate responsibility to service the mortgage loans underlying the MSRs. Therefore, a failure by a subservicer to satisfy the legal requirements or agency or mortgage investor's guidelines may lead to (i) Lakeview's loss of approved status to service loans, (ii) demands for indemnification, (iii) criminal and civil liability, (iv) fines and penalties and loss of licensing and (v) administrative enforcement actions. If a servicer termination event or event of default has occurred under a pooling and servicing agreement, Lakeview may be terminated as servicer without any right to compensation for the loss of such MSRs, other than the right to be reimbursed for any outstanding servicing advances as the related loans are brought current, modified, liquidated or charged off. Lakeview will generally provide in its subservicing agreements that subservicers will indemnify Lakeview and the Funds for losses incurred from the subservicer's failure to comply with contractual or regulatory requirements. Lakeview, however, may incur expenses in attempting to obtain and enforce such indemnification and, in certain circumstances (such as the bankruptcy of the subservicer), may not obtain full indemnification for its losses.

In addition, servicing contracts may provide mortgage investors (or agencies) with the authority to terminate servicing rights without cause. In such a circumstance, Lakeview may be provided the right to sell the applicable MSRs to another servicer within a certain time frame. If the mortgage investor (or agency) does not provide Lakeview with such right, or Lakeview is unable to arrange a transfer of the MSRs in the time period provided, Lakeview may be paid a termination fee. The termination fee may be insufficient to cover the value of the MSR Funds' investment in the MSRs. The MSR Funds' loss of the MSRs would have a material adverse impact on investors. If (i) a subservicing agreement is terminated with respect to MSRs or (ii) a subservicer is permanently suspended as a servicer of mortgage loans by a regulatory agency or mortgage investor, there is no assurance that Lakeview will be able to find a suitable replacement subservicer at a cost acceptable to Lakeview. Bayview believes that any contractual arrangements with any subservicers could be replicated given the competitive state of the market and the availability of qualified alternate vendors. However, the inability of the MSR Funds to procure a suitable replacement subservicer at an acceptable cost would have a materially adverse effect on MSR investments.

*Risks Associated with Mortgage Servicer Ratings.* Moody's, Standard & Poor's and Fitch rate many mortgage servicers. These ratings are subject to change in the future without notice. Servicer ratings are important to Lakeview's ability to finance servicing advances. For example, the amount of debt that is permitted to be outstanding under any advance financing facility may decrease with downgrades in the servicer ratings of the subservicers. Downgrades in the servicer ratings of subservicers could also affect the terms of advance financing facilities that Lakeview may enter into, as lenders may require higher interest rates or may limit the amount of money that Lakeview can borrow to finance servicing advances if subservicers' ratings are deemed by the lenders to be too low. In addition, certain pooling and servicing agreements may also require that the servicer maintain specified servicer ratings. The failure of a subservicer to maintain the specified rating may result in Lakeview's

termination as servicer. Accordingly, any such downgrade could have an adverse effect on Lakeview's business, financing activities, financial condition and result in losses to the MSR Funds.

*Risks Associated with Foreclosure and Bankruptcy.* When delinquent mortgage loans are resolved through foreclosure, the unpaid balance of such loans may cease to be a part of the aggregate unpaid principal balance upon which the related MSRs servicing fees are based. Also, delinquent mortgage loans resolved through foreclosure generally require more servicing advances over a longer time horizon prior to reimbursement as compared with servicing advances made with respect to delinquent mortgage loans that are resolved through repayment or permitted loan modifications. Accordingly, foreclosures could reduce the amount of servicing fees to which Lakeview or other Controlled Affiliates are entitled and increase servicing costs, which could result in losses to MSR Funds.

In addition to the procedural delays and uncertainties generally incident to the mortgage foreclosure process in various jurisdictions, many states and municipalities have enacted, and other jurisdictions and the federal government have considered or are considering, legislation or regulations that would hinder or delay foreclosure proceedings against defaulted mortgage borrowers, or limit a residential mortgage loan servicer's ability to take actions that are necessary or appropriate to preserve the value of mortgage loans, including mortgage loans underlying RMBS and MSRs. In addition, certain judicial decisions have delayed foreclosure proceedings and imposed significant new requirements on servicers when foreclosing. Further, some legislatures are instituting stringent proof of ownership requirements that a servicer must satisfy before commencing a foreclosure action. The inability to foreclose on defaulted borrowers when or as anticipated, or an increase of expenses for foreclosure proceedings, could result in increased costs to Lakeview or other Controlled Affiliates and result in losses to the MSR Funds.

*The Agencies May Impose Compensatory Fees if Lakeview or other Controlled Affiliates do not Complete Foreclosure Within Prescribed Time Frames.* The agencies require routine, uncontested foreclosure proceedings to be completed within prescribed foreclosure time frames, representing the allowable time lapses between the time the case is referred to the attorney (or trustee) to commence a foreclosure action and the completion of the foreclosure sale. Fannie Mae and Freddie Mac reserve the right to charge a compensatory fee for delays in completing the foreclosure process based on Fannie Mae's and Freddie Mac's monthly monitoring of the servicer's management of the foreclosure process. The compensatory fee is calculated based the outstanding principal balance of the mortgage loan (regardless of the value of the property or the estimated liquidation proceeds), the applicable pass-through rate, the length of the delay, and any additional foreclosure costs that are directly attributable to the delay. Compensatory fees are not imposed in lieu of other remedies that the agencies retain under their contracts for servicing breaches.

The timelines established by the agencies do not necessarily represent the average time it would take a servicer to diligently pursue an uncontested foreclosure in a particular jurisdiction and there is no certainty that Lakeview will meet these timelines in individual cases or report the reasons for the delay in a timely and accurate manner. Failure to meet these time frames on a regular basis likely will result in the imposition of significant compensatory fees.

It is anticipated that potential penalties will be priced into MSR acquisitions, however there can be no assurance that such anticipated penalties will be sufficient to cover the actual penalties. Even though servicing may be undertaken by subservicers, the ultimate responsibility for any penalty will be borne by the owner of the MSRs.

*Risk of Prepayment and Default related to MSRs.* If a mortgage loan is prepaid, the related servicing rights will generate no further income for an MSR investor. If a mortgage loan goes into default, the servicer may not collect a servicing fee for such mortgage loan while it is in default. Following liquidation, the servicing rights on a defaulted mortgage loan will not generate further income for an MSR investor. In addition, the servicer may incur certain costs in connection with foreclosure proceedings on defaulted mortgage loans for which it may not be fully reimbursed. Rates of mortgage loan defaults and prepayments are determined by numerous factors beyond the control of the Funds, including, among others, changes in interest rates, economic trends both nationally and within particular geographical areas, changes in real estate values and changes in federal, state and local laws. The MSR Funds may attempt to hedge against the risks involved from borrower prepayment and default by purchasing and/or selling certain financial instruments. There can be no assurance that such actions will be effective, and the Funds will not be required to hedge any particular risk in connection with a particular transaction or its portfolio generally.

*Advance and Credit Risk related to MSRs.* Pursuant to its servicing agreements, Lakeview may be obligated to make advances to pay taxes, mortgage and hazard insurance premiums, foreclosure expenses, repair and preservation expenses and other similar items. Bayview expects that the subservicing agreements will provide that the subservicers will make all advances and receive reimbursement from the servicer only if the advances are unrecoverable. In other cases, the servicer reimburses subservicers for advances made by such subservicers on a periodic basis prior to the subservicer's attempts to recover such advances. In certain instances, the obligation to advance funds will only arise if there is a reasonable expectation of being reimbursed. This is generally true with respect to property repair and preservation expenses. In other instances, the servicer of mortgage loans will have an obligation to advance funds irrespective of its expectation or ability to be reimbursed, in the case, for example, of property taxes, hazard insurance premiums and principal and interest, if applicable. With respect to certain servicing agreements, primarily relating to MSRs in which the underlying mortgage loans have been pooled and securitized, the servicer may also be required to advance all or part of the scheduled mortgage payments where loan payments are delinquent. If a mortgagor prepays a mortgage loan, the mortgage servicer may be required to pay interest on the related securities until the end of the month to which the prepayment relates. For the most part, the servicer will have the right to be reimbursed for such advances out of any available funds subsequently collected from (i) the resumption of mortgage payments by a delinquent borrower, (ii) liquidation proceeds realized upon the sale of a mortgaged property following foreclosure or other means of acquiring title, (iii) insurance proceeds realized upon the submission of a claim by the servicer on insurance policies maintained on behalf of the mortgage investor, or (iv) in some cases, reimbursement by the mortgage investor if the other sources prove to be insufficient. Not all advances, however, are reimbursable. Advances to securities holders for interest shortfalls on mortgage loan prepayments are not recoverable. In the case of mortgage loans insured by the Federal Housing Administration ("FHA") or guaranteed by the U.S. Department of Veteran Affairs (the "VA"), only two thirds of foreclosure related expenses, or the costs of acquiring title to the mortgaged property, are reimbursable and other fees and expenses are reimbursable only



to prescribed limits. In addition, there may be deductions from the reimbursement if the foreclosure of loans in default is not conducted within prescribed time frames.

In addition, Lakeview may be required to absorb the costs of funds advanced during the time an advance is outstanding. Payments to servicers generally continue during the delinquency of a mortgage loan. Therefore, while certain advances relating to foreclosure proceedings on defaulted mortgage loans may be unrecoverable, the advance risk associated with nonrecourse servicing is primarily a matter of cash flow timing rather than a credit risk. The obligation to make advances and the delay in receipt of reimbursement could have a negative impact on the MSR Funds' cash flow.

Ginnie Mae servicing, however, involves some recourse features with regard to certain VA loans where the servicer is required to share credit losses with the holders of the securities. Under this VA "no-bid" policy for certain VA-guaranteed mortgage loans under the Ginnie Mae program, the servicer is subject to a credit loss if the underlying mortgaged property is sold in foreclosure at a price that is insufficient, along with VA guaranty benefits, to satisfy the outstanding indebtedness of a loan. Additionally, as part of the Ginnie Mae program, loans may be repurchased if they are delinquent or modified, which may result in Lakeview owning such whole loans.

*Additional Risks Associated with Advances by Subservicers.* Although Lakeview will be responsible for funding servicing advances, the subservicers will be responsible for ensuring that servicing advances are made in compliance with the terms of the pooling and servicing agreements relating to the MSRs and its stop loss policy so that the servicing advances with respect to a mortgage loan do not exceed the amount expected to be collected with respect to such mortgage loan. Servicing advances that are improperly made may not be eligible for financing under the advance financing facility relating to the MSRs and may not be reimbursable by the owner of the mortgage loan or the related securitization trust, which would reduce Lakeview's liquidity and may result in losses to the MSR Funds. In the event a subservicer fails to remit advances, Lakeview and Bayview would be responsible. If either Lakeview or the MSR Funds are unable to make such advances, it could result in the termination or loss of MSRs and/or other material adverse consequences to the MSR Funds and their investments.

*United States Military Operations may Increase Risk of Servicemembers Civil Relief Act Shortfalls.* The U.S. Servicemembers Civil Relief Act provides certain relief to borrowers who enter active military service after the origination of the borrower's mortgage loan. These borrowers may not be required to pay interest in excess of 6% per annum. The note holder is also restricted from exercising certain enforcement remedies during the period of the borrower's active duty status. Several states have enacted or are considering similar laws. As a result of military operations in Afghanistan and Iraq, the United States has placed a substantial number of armed forces reservists and members of the U.S. National Guard on active duty status. It is possible that the number of reservists and members of the U.S. National Guard placed on active duty status might remain at high levels for an extended time. To the extent servicemembers are borrowers on loans underlying MSRs the Funds purchase, the interest rate limitation of the U.S. Servicemembers Civil Relief Act, and corollary state laws, will apply to the loans. An increase in the number of borrowers taking advantage of those laws may increase servicing expenses, and may also reduce cash flow and the interest payments collected from those borrowers. In the event of default, some of these laws result in delaying or preventing the loan servicer from exercising remedies for default. If these

events occur, they might result in interest shortfalls on the loans to which the MSR Funds relate, increase servicing costs, and reduce the value of the MSR Funds purchase.

*Violations of Federal, State and Local Laws that may Result in Losses on Mortgage Loans, Rescission of the Loans or Penalties that may Adversely Impact the Funds' Income.* A loan seller's failure to comply with certain requirements of federal and state laws could subject the seller (and any subsequent holders of the mortgage loans) or servicer to monetary penalties or may limit the ability of the Funds to collect all or part of the principal of or interest on the mortgage loans, even if the subsequent holder or servicer was not responsible for and was unaware of those violations. These adverse consequences vary depending on the applicable law and may vary depending on the type or severity of the violation, but they can include:

- the inability of the holder of the loan to collect all of the principal and interest otherwise due on the loan;
- the right of the homeowner to a refund of amounts previously paid (which may include amounts financed by the loan), or to set off those amounts against his or her future loan obligations;
- the liability of the servicer and the mortgage investor for actual damages, statutory damages and punitive damages, civil or criminal penalties, costs and attorneys' fees; and
- in limited circumstances, the ability of the homeowner to rescind, or cancel, the loan.

The terms of the documents under which the MSR Funds intend to purchase MSRs may entitle the holders of the loans to contractual indemnification against these liabilities. For example, the sellers of loans typically represent that each mortgage loan was made in compliance with applicable federal and state laws and regulations at the time it was made. If there is a material breach of that representation, the seller may be contractually obligated to cure the breach or repurchase or replace the affected mortgage loan. If the seller is unable or otherwise fails to satisfy these obligations, the value of the MSRs might be materially and adversely affected. Due to the well publicized recent deterioration in the housing markets, many of the sellers that issued these indemnifications are no longer in business or are unable to financially respond to their indemnification obligations. Consequently, holders of interests of the MSRs might ultimately have to absorb the losses arising from the sellers' violations. While Bayview will attempt to take these factors into account in the prices to be paid for MSRs, there can be no assurances concerning the validity of the assumptions used in pricing decisions. Similar risks apply to the loans that serve as security for mortgage-backed securities ("MBS") and the documentation governing those loans and the MBS.

*Risk of Future Legislative, Regulatory or Judicial Action.* There can be no assurance as to what actions might be taken by any federal, state or municipal legal authority that may adversely affect investments held by the Funds. Such actions could include, by way of example, further restrictions on the ability of the holder of a mortgage loan to foreclose upon default by the borrower or delays in the foreclosure process, encouragement of modification of the terms of mortgage loans in ways that may be adverse to the interests of the holder of the loans or of related securities, and judicial determinations as to whether particular types of mortgage loans are "unfair" under applicable law.

*Litigation Affecting RMBS Transaction Parties.* Recently, there has been an increase in litigation against sponsors, originators, depositors and servicers of mortgage-backed securities. If a servicer becomes subject to litigation relating to the mortgage loans underlying the RMBS, this may increase the costs of such servicer in servicing the related mortgage loans or the expenses of the trust. These expenses are generally reimbursable from payments on the mortgage loans prior to distribution of such payments to holders of the RMBS. In addition, if a servicer is subject to litigation, it may affect the ability of such servicer to perform its obligations under the related servicing agreement, even if such litigation is not related to the mortgage loans included in the securitization trust. If the seller into a securitization becomes subject to litigation, it may affect the ability of the seller to perform any of its obligations to repurchase mortgage loans from the related trust with respect to which there has been a breach of a representation or warranty. This could result in a delay in or reduction of payments on the RMBS issued by such trust, including RMBS invested in by the Funds. No assurance can be made as to the effect such litigation, if any, may have on payments in respect of the related underlying mortgage loans.

*Servicing Advances.* Most RMBS transactions will have provided for the servicers to make certain monthly advances (of principal and interest) and servicing advances pursuant to the applicable servicing agreements. As indicated above, the costs of servicing an increasingly delinquent mortgage loan portfolio may be rising without a corresponding increase in servicing compensation. Any regulatory oversight, proposed legislation and/or governmental intervention designed to protect consumers or otherwise may have an adverse impact on servicers and, as a result, may have an adverse impact on mortgage loans and on RMBS. These factors, among others, may have the overall effect of increasing costs and expenses of servicers while at the same time decreasing servicing cash flow. Such financial difficulties may have a negative effect on the ability of servicers to pursue collections on mortgage loans that are experiencing increased delinquencies and defaults and to maximize recoveries on the sale of underlying properties following foreclosure. Increased levels of delinquencies and defaults on subprime, Alt-A, other non-prime and prime mortgage loans also have resulted in increases in the amounts of advances by servicers of pooled mortgage loans. Many servicers are experiencing advance requirements that are significantly higher in total dollar amount than was anticipated and this can create liquidity or capacity pressures for these servicers. In addition, a servicer may generally stop advancing on a mortgage loan when, in the good faith exercise of its servicing judgment, it believes the proposed advance would not ultimately be recoverable from the related mortgagor, related liquidation proceeds or other recoveries in respect of the mortgage loan. There can be no assurance as to the current or continuing financial condition of any mortgage servicer or its ability to access markets for financing such advances.

Over the past few years, because of depreciating home values, servicers have had to reconsider their assumptions regarding when to make monthly advances and servicing advances to avoid making such advances beyond the time that reimbursement for such advances would be unlikely. Falling home prices have resulted in higher loan-to-value ratios and combined loan-to-value ratios which yield lower recoveries in foreclosure, and an increase in loss severities above those that would have been realized had property values remained the same or continued to increase. If servicers make advances that are not recoverable from the proceeds of the related foreclosure, the Funds' investments in RMBS could suffer losses. In addition, in the event an RMBS servicer determines not to advance, the related RMBS trust will suffer an interest rate shortfall which may result in bond interest shortfalls and may result in lower available credit protection provided that this interest serves

as a form of credit enhancement ("excess interest"). This combined with the introduction of modification programs, including HAMP, and potentially any bankruptcy cramdown legislation or equivalent change based on industry settlements or regulatory requirements, where the servicer can recoup prior advances upon modification and reduce the mortgage interest rate or forbear principal of the underlying mortgage loans, there is the risk that the interest available to the underlying securitization will be reduced in some instances increasing bond interest rate shortfalls and decreasing the overall credit protection of the bond. In addition, this modification of interest rates, specifically by changing adjustable rate loans into a modified loan with a fixed rate, will potentially increase the mismatch between the bond interest adjustment features and the underlying loans. This potential decline in RMBS bond interest may increase the risk of leverage and the basis mismatch between the underlying bonds and the financing.

Although RMBS transactions may provide that the loan servicer is required to make advances in respect of delinquent mortgage loans, servicers experiencing financial difficulties, including those resulting from or exacerbated by servicing-related settlements with governmental entities, regulators or as a result of various civil lawsuits, may not be able to perform these obligations. Servicers who have sought bankruptcy protection may, due to application of the provisions of bankruptcy law, not be required to advance such amounts. Even if a servicer were able to advance amounts in respect of delinquent mortgage loans, its obligation to make such advances may be limited to the extent that it does not expect to recover such advances due to the deteriorating credit of the delinquent mortgage loans. In addition, a servicer's obligation to make such advances may be limited to the amount of its servicing fee. There may be contractual differences related to the requirement of the servicer to advance delinquent principal and interest.

*Credit Enhancement Features.* RMBS may contain certain credit enhancement features intended to enhance the likelihood that holders of such securities will receive regular payments of interest and principal. If delinquencies or defaults occur on the mortgage loans underlying such RMBS, neither the related servicers nor any other entities will advance scheduled monthly payments of interest and principal on delinquent or defaulted mortgage loans if such advances are not likely to be recovered within those transactions. In the event that a servicer does not advance delinquent monthly principal and interest payments, credit enhancement and available funds to pay interest and principal on the related RMBS will be reduced. Servicers have pursued, and are expected to continue to pursue, principal forgiveness, interest rate reduction and other modifications which are expected to accelerate loan losses without any recovery, reduce loan interest rates (thereby reducing amount available to pay interest on the related RMBS), and will result in the servicers recovering, upon modification, the previously advanced principal and interest on the modified mortgage loan. In general, modifications are expected to materially reduce existing and future credit enhancement and RMBS cash flows. There can be no assurance that the credit enhancement, if any, applicable to RMBS will adequately cover any shortfalls in cash available to make payments on such RMBS as a result of such delinquencies or defaults. If substantial losses occur as a result of defaults and delinquent payments on the mortgage loans, the Funds may suffer losses with respect to its ownership of such RMBS. RMBS may be subordinated to one or more other senior classes of securities of the same series for purposes of, among other things, offsetting losses and other shortfalls with respect to the related underlying mortgage loans. In addition, in the case of certain RMBS, no distributions of principal generally will be made with respect to any class until the aggregate principal balances of the more senior classes of securities have been reduced to zero. As a result, subordinate classes of RMBS are

more sensitive to risk of loss and writedowns than senior classes of RMBS. It is expected that a significant amount of RMBS will be fully written off through their life given the unprecedented increase in mortgage delinquencies and loss severities and the magnitude of the housing decline.

*Possible Ambiguities within RMBS Governing Documents.* The current disruption in the mortgage origination and RMBS markets has created uncertainty with respect to the roles of certain deal parties. Various issues have arisen or may arise for which there may not be a clear answer in the transaction documents, such as, for example, whether the trustee is obligated to actively search for breaches of representations and warranties, whether holders of RMBS should be allowed access to all deal documents and whether principal forgiveness should be treated as a realized loss. The manner in which these open issues are resolved, specifically those which impact the receipt and allocation of underlying mortgage cash flows and losses, could adversely impact the Funds' current and future investments in RMBS. Specifically and as a result of the HAMP program, the government and mortgage market participants are recommending that servicers modify loans arguably in conflict with underlying contracts, request amendments of existing underlying contracts, and treat forbearance as an immediate credit loss to the securitization. There is no assurance that the servicers and trustees will consistently apply the HAMP and other programs. Furthermore, the probability, timing and impact of proposed and potential settlements to resolve disputes involving representations and warranties made by originators and servicers, the adequacy of disclosures, and litigation by state attorneys general and others is uncertain and could impact different RMBS bonds in inconsistent and unpredictable ways.

*Repurchases for Breaches of Representations and Warranties.* The increased levels of delinquencies and defaults described throughout these risk factors, as well as a deterioration in general real estate market conditions, have also resulted generally in loan originators being required to repurchase an increasingly greater number of mortgages loans pursuant to early payment default and representation and warranty provisions in their loan sale agreements. This has led to deterioration in the financial performance of many loan originators. In some cases, such deterioration has caused certain loan originators to cease operations. Any such deterioration could adversely affect the ability of a loan originator to repurchase or substitute for mortgage loans as to which a material breach of representation or warranty exists or to service mortgage loans. The inability of an originator to repurchase or substitute for defective mortgage loans would likely cause the related mortgage loans to experience higher rates of delinquencies, defaults and losses. As a result, shortfalls in the distributions due on the related RMBS could occur. Even in cases where a loan originator has the economic ability to repurchase loans, the increasing volume of repurchase claims has resulted in longer periods between when a repurchase claim is presented and when it is resolved, and a greater proportion of claims being refused or contested by originators.

*Risks Related to Downgrades or Withdrawals of Ratings.* Each of the rating agencies has been downgrading, or placing for downgrade review, the ratings it assigned to numerous tranches of RMBS. Such rating actions affect securities with an original face value of billions of dollars. Currently, outstanding RMBS, regardless of vintage or collateral type, have been subjected to unusually severe ratings downgrades. Nearly all of the RMBS that were originally rated "AAA" (or its equivalent) by one or more rating agencies and issued since 2005 have been downgraded or placed on downgrade watch, and the ratings on some of these securities have fallen or may fall below investment grade. It is likely that such adverse rating actions on RMBS will continue in the foreseeable future. The ratings of RMBS owned

by the Funds (a) may already have been downgraded, withdrawn or not confirmed, (b) may be in the process of being downgraded, withdrawn or not confirmed or (c) may be subject to future ratings downgrades, withdrawals or confirmation failures. Any such rating actions may have a material adverse effect on the liquidity and market value of such RMBS owned by the Funds, including the negative impact on market makers' willingness to provide a secondary market in these assets due to the increased risk and potential higher capital charges.

In addition, each of the rating agencies have indicated that it will change or consider changing, its ratings methodology for RMBS and adopt more conservative assumptions and approaches to loss severity analysis used to rate such securities. Any such changes in methodology may result in additional downgrades and withdrawal of ratings of such RMBS, which may have a material adverse effect on the liquidity and market value of RMBS owned by the Funds.

*Certain RMBS Structural Features May Reduce Return on Investment.* Structural features of RMBS may contribute to the impact of increased delinquencies and defaults and lower recoveries on the underlying mortgage pool. In particular, there may be a decline in the interest rate payable under those RMBS structured to limit interest payable to investors based on a weighted average coupon cap. Mortgage loans bearing interest at a higher rate will have a greater tendency to default than those with lower mortgage rates. Such defaults will reduce the weighted average coupon of the underlying mortgage loans and accordingly the interest rate payable to investors in the related RMBS. In addition, delinquencies, defaults and lower recoveries on underlying mortgage loans will reduce interest and principal actually paid to investors to less than the amounts owed to investors in accordance with the terms of their RMBS. RMBS may not be structured with significant or any overcollateralization, so their performance will be sensitive to delays or reductions in payments, particularly in the case of subordinated tranches of RMBS. To the extent that RMBS provide for writedowns of principal, interest will generally cease to accrue on the portion of principal of an RMBS that has been written down. To the extent that RMBS does not provide for writedowns of principal, remaining unpaid principal bond balances may exceed remaining unpaid underlying mortgage balances, thereby potentially causing additional bond cash flow shortfalls. Furthermore, RMBS commonly include performance related triggers, including those related to delinquency and cumulative loss, that define how available mortgage principal and interest is allocated among related bonds. These triggers will determine whether the most senior or subordinate classes will receive cash flow in any particular month. The ability to model and accurately predict the actual trigger status on a monthly basis will have a material impact on the performance of RMBS assets.

*Re-performing Mortgage Loans.* The Funds may invest in mortgage loans that have previously been in default or delinquent in payment and that, at the time such mortgage loans are acquired by the Funds, are in compliance with the terms of the related mortgage loan documents and are no longer delinquent. While these mortgage loans may have been acquired at a price that reflects the fact that the mortgage loans are re-performing at the time of acquisition, there can be no assurance that such mortgage loans will continue to be current and/or in compliance with the terms of the related mortgage loan document during the time period in which the Funds own such mortgage loans. It is therefore possible that re-performing loans may become non-performing loans and be subject to the same concomitant risks.

*Interest-Only Mortgage Loans.* The Funds may invest in interest-only mortgage loans and MSR for pools of interest-only mortgage loans. Interest-only mortgage loans permit the borrowers to make monthly payments of only accrued interest for the first 60 or 120 months following origination. After such interest-only period, the borrower's monthly payment will be recalculated to cover both interest and principal so that the mortgage loan will amortize fully prior to its final payment date. Interest-only loans are relatively new to the non-prime mortgage sector. As a result, the long-term performance characteristics of these loans are largely unknown. If the monthly payment increases, the related borrower may not be able to pay the increased amount and may default or may refinance the related mortgage loan to avoid the higher payment. Such default or refinancing would also reduce servicing fee revenues and increase servicing expenses and therefore adversely affect any related MSRs held by the MSR Funds. Interest-only mortgage loans reduce the monthly payment required by borrowers during the interest-only period and consequently the monthly housing expense used to qualify borrowers. As a result, the interest-only mortgage loans may allow some borrowers to qualify for a mortgage loan that would not otherwise qualify for a fully amortizing mortgage loan or may allow them to qualify for a larger mortgage loan than otherwise would be the case.

*Geographic Concentration of Mortgage Loans.* The mortgage loans and securities backed by mortgage loans in which the Funds may invest may be concentrated in a specific state or states. Similarly, the MSRs in which the MSR Funds invest may be related to mortgage loans that are concentrated in a specific state or states. Weak economic conditions in these locations or any other location (which may or may not affect real property values), may affect the ability of borrowers to repay their mortgage loans on time. Such inability of borrowers to repay their mortgage loans on time would also reduce servicing fee revenues and increase servicing expenses of related MSRs held by the MSR Funds. Properties in certain jurisdictions may be more susceptible than properties located in other parts of the country to certain types of uninsurable hazards, such as earthquakes, floods, hurricanes, wildfires, mudslides and other natural disasters. Declines in the residential real estate market of a particular jurisdiction may reduce the values of properties located in that jurisdiction, which would result in an increase in the loan-to-value ratios. Any increase in the market value of properties located in a particular jurisdiction would reduce the loan-to-value ratios of the mortgage loans and could, therefore, make alternative sources of financing available to the borrowers at lower interest rates, which could result in an increased rate of prepayment of the mortgage loans and reduce servicing fee revenues. Natural disasters, such as wildfires, severe storms and flooding affecting regions of the United States from time to time may result in prepayments of mortgage loans. Properties located in certain parts of the southern and eastern United States may have been damaged by the hurricanes, tropical storms and tornadoes that recently affected those areas.

*Risks Associated with Commercial Mortgage Loans.* The Funds may invest in commercial mortgage loans, mortgage-backed securities on commercial mortgage loans and MSRs for commercial mortgage loans. The value of the Funds' commercial mortgage loans, mortgage-backed securities on commercial mortgage loans, and MSRs for commercial mortgage loans will be influenced by the rate of delinquencies and defaults experienced on the commercial mortgage loans and by the severity of loss incurred as result of such defaults. The factors influencing delinquencies, defaults and loss severity include: (i) economic and real estate market conditions by industry sectors (e.g., multifamily, retail, office, etc.); (ii) the terms and structure of the mortgage loans; and (iii) any specific limits to legal and financial recourse upon a default under the terms of the mortgage loan.

Commercial mortgage loans are generally viewed as having a greater risk of loss through delinquency and foreclosure than lending on the security of single family residences. The ability of a borrower to repay a loan secured by income-producing property typically is dependent primarily upon the successful operation and operating income of such property (*i.e.*, the ability of tenants to make lease payments, the ability of a property to attract and retain tenants, and the ability of the owner to maintain the property, minimize operating expenses and comply with applicable zoning and laws) rather than upon the existence of independent income or assets of the borrower. Many commercial mortgage loans provide recourse only to specific assets, such as the property, and not against the borrower's other assets or personal guarantees.

Commercial mortgage loans generally do not fully amortize, which can necessitate a sale of the property or refinancing of the remaining "balloon" amount at or prior to maturity of the mortgage loan. Accordingly, investors in commercial mortgage loans and commercial mortgage-backed securities ("CMBS") bear the risk that the borrower will be unable to refinance or otherwise repay the mortgage at maturity, thereby increasing the likelihood of a default on the borrower's obligation.

Exercise of foreclosure and other remedies may involve lengthy delays and additional legal and other related expenses on top of potentially declining property values. In certain circumstances, the creditors may also become liable upon taking title to an asset for environmental or structural damage existing at the property. Such circumstances could also increase servicing costs and negatively impact cash flows for the owner of the related MSRs.

*Risks Associated with Assumptions in Determining Purchase Price.* The success of the MSR Funds will be highly dependent upon accurate pricing of MSRs. In determining the purchase price for MSRs, Bayview will make assumptions regarding: the rates of prepayment and repayment of the underlying mortgage loans, the amount of future servicing advances; projected rates of delinquencies and defaults; future interest rates; and the costs associated with engaging subservicers to service the loans. If any of Bayview's assumptions regarding the MSRs acquired are inaccurate or the basis for such assumptions change, the price paid to acquire such MSRs may prove to be too high, which could result in losses to the Funds.

*Limited Investigation.* While Bayview will conduct reasonable due diligence of prospective MSRs prior to their purchase by the MSR Funds, it will not be possible to perform an investigation that is certain to identify all negative factors with respect to the seller or the MSRs due to the number of mortgage loans involved in each portfolio, the cost of conducting such an investigation and limitations on available time. Thus, various negative factors concerning the seller or the MSRs may come to light after the MSR Funds have acquired the portfolio. The acquisition agreements that the MSR Funds use when acquiring MSRs generally do not limit the MSR Funds' right to seek indemnification from the seller for defects in the MSRs that the MSR Funds either discovered or failed to discover during its investigation.

*Repurchases of Loans.* The Funds may sell individual loans or pools of loans. In connection with such transactions, the Funds generally expect to enter into agreements customary to the nature and size of the transaction. In those agreements, the Funds generally will be required to make certain representations and warranties regarding each loan or pool of loans. In the event of an uncured breach of certain representations or warranties contained in such



agreements, the Funds may be obligated to repurchase loans or a pool of loans from the purchaser.

*Lack of Information Regarding Underwriting Standards; Higher Expected Delinquencies in Payment.* The Funds may acquire mortgage loans and non-agency MSR for mortgage loans from various unaffiliated savings institutions, finance companies and other sellers. When investing in such mortgage loans and MSRs, from time to time, the seller will not have information available to it as to the underwriting standards that were applied in originating the mortgage loans, and such mortgage loans may have been originated in accordance with standards less strict than those of Fannie Mae and Freddie Mac. As a result, certain mortgage loans underlying the MSR Funds' MSRs and certain mortgage loans owned by the Funds may experience higher than expected rates of delinquency and defaults, which could result in losses to the Funds. Changes in the values of mortgaged properties may have a greater effect on the delinquency, default and loss experience of the mortgage loans in the Funds than on mortgage loans that were originated under stricter guidelines.

*Successor in Interest to the Representations and Warranties of the Originator.* In many instances, servicing contracts may require that the servicer assume the original sales representations and warranties relating to the mortgage loans underlying the MSRs that were made by the seller of such mortgage loans. If those representations and warranties have been breached, Lakeview may be required to repurchase such mortgage loans. Any subsequent loss on such repurchased mortgage loans on their resale or foreclosure by Lakeview would be borne by the MSR Funds, subject to any indemnification rights the Funds may have in its contract with the seller of the MSRs. The MSR Funds intend to provide in their agreements relating to the acquisition of MSRs that the seller of MSRs to the MSR Funds will indemnify the MSR Funds for any losses they incur as a result of the seller's, any prior servicer's or any originator's non-compliance with contractual or regulatory requirements. Again, the MSR Funds may incur expenses in attempting to obtain indemnification and, in certain circumstances, may not obtain full indemnification for their losses. The MSR Funds intend to perform due diligence investigations on MSRs the MSR Funds purchase, although there can be no assurance that such investigations will uncover all such breaches.

*Greater Risk Involving Certain Property Types.* The Funds may invest in residential, commercial and consumer performing, non-performing and re-performing whole loans. The MSR Funds may also invest in MSRs for a variety of residential, commercial and consumer performing and non-performing mortgage loans. Mortgage loans secured by multifamily property, mixed use property or commercial property may incur higher losses as a result of delinquency, foreclosure or repossession than mortgage loans secured by single-family residential property. In addition, any such losses could also reduce servicing fees on the related MSRs, increase servicing costs and therefore result in losses to the MSR Funds.

*Higher Risk of Loss on Loans Secured by Non-Owner Occupied Properties.* The Funds may invest in mortgage loans that are secured by commercial, multifamily or mixed use properties, or by properties, including improved and unimproved land, held by borrowers for investment, or by second homes. The MSR Funds may also invest in MSRs for mortgage loans related to commercial, multifamily or mixed use properties, or related to properties, including improved and unimproved land, held by borrowers for investment, or by second homes. These mortgage loans may present a greater risk of loss, and the unimproved land may present a significantly greater risk of loss, if a borrower experiences financial difficulties, because these borrowers may be more likely to default on a mortgage loan

secured by non-owner occupied property than a mortgage loan secured by a primary residence of a borrower. Any such losses could also reduce servicing fees on the related MSRs, increase servicing costs and result in losses to the MSR Funds.

*Credit Scores May Not Accurately Predict the Performance of the Mortgage Loans.* Bayview may rely on credit scores as part of its due diligence process. Credit scores are obtained by many lenders in connection with mortgage loan applications to help them assess a borrower's creditworthiness. Credit scores are generated by models developed by a third party that analyzed data on consumers in order to establish patterns that are believed to be indicative of the borrower's probability of default over a two-year period. The credit score is based on a borrower's historical credit data, including, among other things, payment history, delinquencies on accounts, levels of outstanding indebtedness, length of credit history, types of credit and bankruptcy experience. Credit scores range from approximately 250 to approximately 900, with higher scores indicating an individual with a more favorable credit history compared to an individual with a lower score. However, a credit score purports only to be a measurement of the relative degree of risk a borrower represents to a lender (*i.e.*, a borrower with a higher score is statistically expected to be less likely to default in payment than a borrower with a lower score). Lenders have varying ways of analyzing credit scores and, as a result, the analysis of credit scores across the industry is not consistent. In addition, it should be noted that credit scores were developed to indicate a level of default probability over a two-year period, which does not correspond to the life of a mortgage loan. Furthermore, credit scores were not developed specifically for use in connection with mortgage loans, but for consumer loans in general, and assess only the borrower's past credit history. Therefore, a credit score does not take into consideration the effect of mortgage loan characteristics (which may differ from consumer loan characteristics) on the probability of repayment by the borrower. There can be no assurance that the credit scores of the mortgagors will be an accurate predictor of the likelihood of repayment of the related mortgage loans. Any delinquencies or defaults on mortgage loans underlying an MSR could reduce servicing fees on the related MSRs, increase servicing costs and therefore result in losses to the MSR Funds.

*Environmental Risks.* Real property pledged as security for a mortgage loan may be subject to certain environmental risks. Under the laws of certain states, contamination of a property may give rise to a lien on the property to ensure payment of the costs of cleanup. In several states, such a lien has priority over the lien of an existing mortgage against the property. In addition, under the laws of some states and under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, a lender may be liable, as an "owner" or "operator", for costs of addressing releases or threatened releases of hazardous substances that require remedy at a property if agents or employees of the lender have become sufficiently involved in the operations of the borrower, regardless of whether or not the environmental damage or threat was caused by a prior owner.

A lender also risks such liability on foreclosure of the mortgage. Any such lien arising with respect to a mortgaged property would adversely affect the value of the mortgaged property and could make impracticable foreclosure on the mortgaged property in the event of a default by the related borrower. In addition, certain environmental laws impose liability for releases of asbestos into the air. Third parties may seek recovery from owners or operators of real property for personal injury associated with exposure to asbestos, lead paint, radon or other hazardous substances. Property owners in some areas have recently been subject to liability claims associated with mold.

## Risks Related to Asset-Backed Securities and Derivatives

*Risks Associated with Commercial Mortgage-Backed Securities.* The Funds may invest in CMBS and other mortgage-backed securities, including subordinated tranches of such securities. The value of CMBS will be influenced by factors affecting the value of the underlying real estate portfolio, and by the terms and payment histories of such CMBS.

Some or all of the CMBS contemplated to be acquired by the Funds may not be rated, or may be rated lower than investment-grade securities, by one or more nationally recognized statistical rating organizations. Lower-rated or unrated CMBS, or "B-pieces", in which the Funds intend to invest have speculative characteristics and can involve substantial financial risks as a result. The prices of lower credit quality securities have been found to be less sensitive to interest rate changes than more highly rated investments, but more sensitive to adverse economic or real estate market conditions or individual issuer concerns. Securities rated lower than "B" by the rating organizations can be regarded as having extremely poor prospects of ever attaining any real investment standing and may be in default. Existing credit support and the owner's equity in the property may be insufficient to protect the Funds from loss. As an investor in subordinated CMBS in particular, the Funds will be first in line among debt holders to bear the risk of loss from delinquencies and defaults experienced on the collateral.

The Funds may acquire subordinated tranches of CMBS issuances. In general, subordinated tranches of CMBS are entitled to receive repayment of principal only after all principal payments have been made on more senior tranches and also have subordinated rights as to receipt of interest distributions. Such subordinated tranches are subject to a greater risk of non-payment than are senior tranches of CMBS or CMBS backed by third-party credit enhancement. In addition, an active secondary market for such subordinated securities is not as well developed as the market for certain other mortgage-backed securities. Accordingly, such subordinated CMBS may have limited marketability and there can be no assurance that a more efficient secondary market will develop.

The value of CMBS and other mortgage-backed securities in which the Funds may invest generally will have an inverse relationship with interest rates. Accordingly, if interest rates rise, the value of such securities will decline. In addition, to the extent that the mortgage loans which underlie specific mortgage-backed securities are prepayable, the value of such mortgage securities may be negatively affected by increasing prepayments, which generally occur when interest rates decline. Typically, commercial mortgage loans are not prepayable or are subject to prepayment penalties or interest rate adjustments, while the principal on most residential mortgage loans generally may be prepaid at any time without penalty.

*MBS and ABS—Generally.* The Funds may invest in MBS and asset-backed securities ("ABS"). The investment characteristics of MBS and ABS differ from traditional debt securities. Among the major differences are that interest and principal payments are made more frequently, usually monthly, and that principal may be prepaid at any time because the underlying mortgage loans or other assets generally may be prepaid at any time.

*MBS and ABS—Prepayment Risk.* The frequency at which prepayments (including voluntary prepayments by the obligors and liquidations due to defaults and foreclosures) occur on loans underlying MBS and ABS will be affected by a variety of factors including the prevailing level of interest rates as well as economic, demographic, tax, social, legal and other factors.

Generally, mortgage obligors tend to prepay their mortgages when prevailing mortgage rates fall below the interest rates on their mortgage loans. Although ABS are generally less likely to experience substantial prepayments than are MBS, certain of the factors that affect the rate of prepayments on MBS also affect the rate of prepayments on ABS. However, during any particular period, the predominant factors affecting prepayment rates on MBS and ABS may be different.

In general, "premium" securities (securities whose market values exceed their principal or par amounts) are adversely affected by faster than anticipated prepayments, and "discount" securities (securities whose principal or par amounts exceed their market values) are adversely affected by slower than anticipated prepayments. Since many MBS and ABS will be discount securities when interest rates are high, and will be premium securities when interest rates are low, these MBS and ABS may be adversely affected by changes in prepayments in any interest rate environment.

The adverse effects of prepayments may impact the Funds' portfolio in two ways. First, particular investments may experience outright losses, as in the case of an interest-only security in an environment of faster actual or anticipated prepayments. Second, particular investments may underperform relative to any hedges that Bayview may have constructed for these investments, resulting in a loss to the Funds' overall portfolios. In particular, prepayments (at par) may limit the potential upside of many MBS and ABS to their principal or par amounts, whereas any corresponding hedges made by the Funds often have the potential for unlimited loss.

*MBS and ABS—Credit Support Limitations.* The amount, type and nature of insurance policies, subordination, letters of credit and other credit support, if any, with respect to certain ABS and MBS are based upon actuarial analysis and therefore are inherently limited in their ability to predict events to take place in the future. There can also be no assurance that data derived from a large pool of mortgage loans accurately predicts the delinquency, foreclosure or loss experience of any particular pool of loans.

Legislation has been introduced in the U.S. Congress that would permit courts to modify the terms of mortgage loans of borrowers who file for bankruptcy protection under Chapter 13 of the U.S. Bankruptcy Code. If this legislation is ever enacted, a bankruptcy court could reduce the interest rate, extend the maturity and/or reduce the amount of the principal balance that is secured by the mortgage to the value of the mortgaged property. Under the terms of some mortgage-backed securitizations, losses resulting from reduction of the secured mortgage debt in bankruptcy will be allocated proportionately among all holders of the related MBS, without regard to seniority. As a result, holders of senior MBS, including the Funds, could incur losses substantially greater than anticipated.

*Commercial MBS.* Mortgage loans on commercial properties underlying MBS often are structured so that a substantial portion of the loan principal is not amortized over the loan term and is instead payable at maturity. Repayment of the loan principal therefore often depends upon the future availability of real estate financing from the existing or an alternative lender and/or upon the current value and salability of the real estate. Therefore, the unavailability of real estate financing may lead to default. Many commercial mortgage loans underlying MBS are effectively nonrecourse obligations of the borrower, meaning that there is no recourse against the borrower's assets other than the collateral. If borrowers are not able or willing to refinance or dispose of encumbered property to pay the principal and interest

owed on such mortgage loans, payments on the subordinated classes of the related MBS are likely to be adversely affected. The ultimate extent of the loss, if any, to the subordinated classes of MBS may only be determined after a negotiated discounted settlement, restructuring or sale of the mortgage note, or the foreclosure (or deed in lieu of foreclosure) of the mortgage encumbering the property and subsequent liquidation of the property. Foreclosure can be costly and delayed by litigation and/or bankruptcy. Factors such as the property's location, the legal status of title to the property, its physical condition and financial performance, environmental risks, and governmental disclosure requirements with respect to the condition of the property may make a third party unwilling to purchase the property at a foreclosure sale or to pay a price sufficient to satisfy the obligations with respect to the related MBS. Revenues from the assets underlying such MBS may be retained by the borrower and the return on investment may be used to make payments to others, maintain insurance coverage, pay taxes or pay maintenance costs. Such diverted revenue is generally not recoverable without a court appointed receiver to control collateral cash flow.

*ABS.* Through the use of trusts and special purpose corporations, various types of assets, primarily automobile and credit card receivables, are securitized in pass through structures. The Funds may invest either directly or indirectly, through collateralized debt obligations ("CDOs"), in these and other types of ABS that may be developed in the future.

ABS present certain risks that are not presented by MBS. Primarily, these financial instruments do not have the benefit of the same security interest in the related collateral. Credit card receivables, for example, are generally unsecured and the debtors are entitled to the protection of a number of state and federal consumer loan laws, many of which give such debtors the right to set off certain amounts owed on the credit cards, thereby reducing the balance due. Most issuers of ABS backed by automobile receivables permit the servicers to retain possession of the underlying obligations. If the servicer were to sell these obligations to another party, there is a risk that the purchaser would acquire an interest superior to that of the holders of the related ABS. In addition, because of the large number of vehicles involved in a typical issuance and technical requirements under state laws, the trustee for the holders of the ABS may not have a proper security interest in all of the obligations backing such ABS. Therefore, there is a possibility that recoveries on repossessed collateral may not, in some cases, be available to support payments on these securities. The risk of investing in ABS is ultimately dependent upon payment of consumer loans by the debtor.

The collateral supporting ABS is of shorter maturity than mortgage loans and is less likely to experience substantial prepayments. As with MBS, ABS are often backed by a pool of assets representing the obligations of a number of different parties and use credit enhancement techniques such as letters of credit, guarantees or preference rights. The value of an ABS is affected by changes in the market's perception of the asset backing the security and the creditworthiness of the servicing agent for the loan pool, the originator of the loans or the financial institution providing any credit enhancement, as well as by the expiration or removal of any credit enhancement.

*"Widening" Risk.* For reasons not necessarily attributable to any of the risks enumerated above (for example, supply/demand imbalances or other market forces), the prices of the securities in which the Funds invest may decline substantially. In particular, purchasing assets at what may appear to be "undervalued" levels is no guarantee that these assets will not be trading at even more "undervalued" levels at a time of valuation or at the time of sale. It may not be possible to predict, or to hedge against, such "spread widening" risk.

*General Risks of CDO Investments.* The value of the CDOs owned by the Funds generally will fluctuate with, among other things, the financial condition of the obligors or issuers of the underlying portfolio of assets of the related CDO ("CDO Collateral"), general economic conditions, the condition of certain financial markets, political events, developments or trends in any particular industry and changes in prevailing interest rates. Consequently, holders of CDOs must rely solely on distributions on the CDO Collateral or proceeds thereof for payment in respect thereof.

CDO Collateral may consist of high yield debt securities, loans, ABS and other instruments, which often are rated below investment grade (or of equivalent credit quality). The lower ratings of high yield securities and below investment grade loans reflect a greater possibility that adverse changes in the financial condition of an issuer or in general economic conditions or both may impair the ability of the related issuer or obligor to make payments of principal or interest.

*Credit Default Swaps.* Certain Funds may enter into credit derivative contracts such as credit default swaps ("CDS"), LCDS, CDX and LCDX contracts. The typical CDS and LCDS contract requires the seller to pay to the buyer, in the event that a particular reference entity experiences specified credit events, the difference between the notional amount of the contract and the value of a portfolio of securities or loans issued by the reference entity that the buyer delivers to the seller. In return, the buyer agrees to make periodic and/or upfront payments equal to a fixed percentage of the notional amount of the contract. The Funds may also purchase or sell credit default swaps on a basket of reference entities or an index that is CDX and LCDX contracts. In circumstances in which the Funds do not own the debt or loans that are deliverable under a credit default swap, the Funds will be exposed to the risk that deliverable securities or loans will not be available in the market, or will be available only at unfavorable prices, as would be the case in a so-called "short squeeze". In certain instances of issuer defaults or restructurings, it has been unclear under the standard industry documentation for credit default swaps whether or not a "credit event" triggering the seller's payment obligation had occurred. In either of these cases, the Funds would not be able to realize the full value of the credit default swap upon a default by the reference entity. As a seller of credit default swaps, the Funds incur leveraged exposure to the credit of the reference entity and are subject to many of the same risks they would incur if they were holding debt securities or loans issued by the reference entity. However, the Funds will not have any legal recourse against the reference entity and will not benefit from any collateral securing the reference entity's debt obligations. In addition, the credit default swap buyer will have broad discretion to select which of the reference entity's debt obligations to deliver to the Funds following a credit event and will likely choose the obligations with the lowest market value in order to maximize the payment obligations of the Funds. Given the recent sharp increases in volume of credit derivatives trading in the market, settlement of such contracts may also be delayed beyond the time frame originally anticipated by counterparties. Such delays may adversely impact the Funds' ability to otherwise productively deploy any capital that is committed with respect to such contracts.

*Interest Rate Risk.* The value of the fixed rate securities in which the Funds may invest generally will have an inverse relationship with interest rates. Accordingly, if interest rates rise the value of such securities may decline. In addition, to the extent that the receivables or loans underlying specific securities are prepayable without penalty or premium, the value of such securities may be negatively affected by increasing prepayments, which generally occur when interest rates decline.

In addition, if mortgage loan interest rates fall, an increasing number of homeowners will seek to refinance and prepay their mortgage loans. When a mortgage loan is prepaid, it will no longer produce any MSR-related revenue for the MSR Funds. Therefore, a sustained decline in mortgage loan interest rates will generally result in a reduction in servicing income to the MSR Funds. Because the value of MSRs is a function of the anticipated stream of revenues generated by servicing the mortgage loans, the value of MSRs will decline as mortgage loan interest rates fall and more prepayments are anticipated. Conversely, an increase in mortgage loan interest rates is likely to result in a decreased number of refinancings. The MSR Funds may attempt to hedge against the risks involved from interest rate changes by purchasing and/or selling certain financial instruments. While the MSR Funds may hedge against any losses of servicing income and loss of value of the MSRs that may be incurred from interest rate fluctuations, there can be no assurance that such actions will be effective.

*Troubled Origination.* The investments chosen by Bayview may have been originated by financial institutions or other entities that are insolvent, in serious financial difficulty or no longer in existence. As a result, the standards by which such investments were originated, the recourse to the selling institution, or the standards by which such investments are being serviced or operated may be adversely affected.

*Hedging/Derivative Instruments.* The Funds intend to use derivative financial instruments, including without limitation, futures, swaps, options, floors, total return swaps, and CDS, IOS, POS, LCDS, CDX, LCDX, ABX and CMBX contracts, primarily for leveraging and hedging purposes. The use of derivative instruments involves a variety of material risks, including the high degree of leverage often embedded in such instruments and the possibility of counterparty non-performance as well as of material and prolonged deviations between the actual and the theoretical value of a derivative (*i.e.*, non-conformance to anticipated or historical correlation patterns). In addition, the markets for certain derivatives are frequently characterized by limited liquidity, which can make it difficult as well as costly to the Funds to close out positions in order either to realize gains or to limit losses.

Many of the derivatives which the Funds trade in will be principal to principal or "over the counter" contracts between the Funds and third parties entered into privately, rather than on an exchange. As a result, the Funds are not afforded the regulatory and financial protections of an exchange or its clearinghouse (or of the government regulator that oversees such exchange and clearinghouse). In privately negotiated transactions, the risk of the negotiated price deviating materially from fair value is substantial, particularly when there is no active market available from which to derive benchmark prices.

Many derivatives are valued on the basis of dealers' pricing of these instruments. However, the price at which dealers value a particular derivative and the price that the same dealers would actually be willing to pay for such derivative should the Funds wish or be forced to sell may be materially different. Such differences can result in an overstatement of the Funds' net assets and could materially adversely affect the Funds in situations in which the Funds are required to sell derivative instruments.

### Other Risks

*Short Selling.* Short selling involves selling securities which may or may not be owned by the short seller and borrowing them for delivery to the purchaser, with an obligation to

replace the borrowed securities at a later date. Short selling allows the investor to profit from a decline in market price to the extent such decline exceeds the transaction costs and the costs of borrowing the securities. The extent to which the Funds engage in short sales will depend upon the Funds' investment strategy and opportunities. A short sale creates the risk of a theoretically unlimited loss, in that the price of the underlying security could theoretically increase without limit, thus increasing the cost to the Funds of buying those securities to cover the short position. There can be no assurance that the Funds will be able to maintain the ability to borrow securities sold short. In such cases, the Funds can be "bought in" (*i.e.*, forced to repurchase securities in the open market to return to the lender). There also can be no assurance that the securities necessary to cover a short position will be available for purchase at or near prices quoted in the market. Purchasing securities to close out a short position can itself cause the price of the securities to rise further, thereby exacerbating the loss.

*Necessity for Counterparty Trading Relationships; Counterparty Risk in General.* The Funds expect to establish relationships to obtain financing, derivative intermediation and prime brokerage services that permit the Funds to trade in any variety of markets or asset classes over time; however, there can be no assurance that the Funds will be able to maintain such relationships or establish such relationships. An inability to establish or maintain such relationships would limit the Funds' trading activities and could create losses, preclude the Funds from engaging in certain transactions, financing, derivative intermediation and prime brokerage services and prevent the Funds from trading at optimal rates and terms. Moreover, a disruption in the financing, derivative intermediation and prime brokerage services provided by any such relationships before the Funds establish additional relationships could have a significant impact on the Funds' business due to the Funds' reliance on such counterparties.

Some of the markets in which the Funds may effect transactions are "over-the-counter" or "interdealer" markets. The participants in such markets are typically not subject to credit evaluation and regulatory oversight as are members of "exchange-based" markets. This exposes the Funds to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a dispute over the terms of the contract (whether or not *bona fide*) or because of a credit or liquidity problem, thus causing the Funds to suffer a loss. In addition, in the case of a default, the Funds could become subject to adverse market movements while replacement transactions are executed. Such "counterparty risk" is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where the Funds have concentrated their transactions with a single counterparty or small group of counterparties.

Furthermore, there is a risk that any of the Funds' counterparties could become insolvent and/or the subject of insolvency proceedings. If one or more of the Funds' counterparties were to become insolvent or the subject of insolvency proceedings in the United States (either under the Securities Investor Protection Act or the United States Bankruptcy Code), there exists the risk that the recovery of the Funds' securities and other assets from the Funds' prime brokers or broker-dealers will be delayed or be of a value less than the value of the securities or assets originally entrusted to such prime broker or broker-dealer.

In addition, the Funds may use counterparties located in jurisdictions outside the United States. Such counterparties are subject to the laws and regulations in foreign jurisdictions that are designed to protect their customers in the event of their insolvency. However, the



practical effect of these laws and their application to the Funds' assets are subject to substantial limitations and uncertainties. Because of the large number of entities and jurisdictions involved and the range of possible factual scenarios involving the insolvency of a counterparty, it is impossible to generalize about the effect of their insolvency on the Funds and their assets.

The Funds are not restricted from dealing with any particular counterparty or from concentrating any or all of their transactions with one counterparty. Moreover, the Funds' internal credit function which evaluates the creditworthiness of the Funds' counterparties may prove insufficient. The ability of the Funds to transact business with any one or more counterparties, the lack of complete and "foolproof" evaluation of the financial capabilities of the Funds' counterparties and the absence of a regulated market to facilitate settlement may increase the potential for losses by the Funds.

*Co-Investments with Third Parties.* The Funds may co-invest with third parties through joint ventures or other entities. Such investments may involve risks in connection with such third-party involvement, including the possibility that a third-party co-venturer may have financial difficulties resulting in a negative impact on such investment; may have economic or business interests or goals that are inconsistent with those of the Funds; or may be in a position to take (or block) action in a manner contrary to the Funds' investment objectives. In those circumstances where such third parties involve a management group, such third parties may enter into compensation arrangements relating to such investments, including incentive compensation arrangements. Such compensation arrangements will reduce the returns to participants in the investments and create potential conflicts of interest between such parties and the Funds.

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

*Volatility Risk.* The Funds' investment programs may involve the purchase and sale of relatively volatile instruments such as derivatives, which are frequently valued based on implied volatilities of such derivatives compared to the historical volatility of underlying financial instruments. Fluctuations or prolonged changes in the volatility of such instruments, therefore, can adversely affect the value of investments held by the Funds. In addition, many non-U.S. financial markets are not as developed or as efficient as those in the U.S., and as a result, price volatility may be higher for the Funds' investments.

*Competition; Availability of Investments.* The markets in which the Funds invest are extremely competitive for attractive investment opportunities and, as a result, there may be reduced expected investment returns. There can be no assurance that the Funds will be able to identify or successfully pursue attractive investment opportunities in such environments. Among other factors, competition for suitable investments from other pooled investment vehicles, independent mortgage loan servicers, large financial institutions, the public equity markets and other investors may reduce the availability of investment opportunities. Competitive investment activity by other firms and institutions will reduce the Funds' opportunity for profit by generally increasing price pressure on desired assets, reducing

mispricings in the market as well as the margins available on those mispricings that can still be identified.

*Equity Securities.* The Funds may invest in equity and equity-related securities of U.S. and non-U.S. companies. Equity securities fluctuate in value in response to many factors, including the activities, results of operations and financial condition of individual companies, the business market in which individual companies compete, industry market conditions, interest rates and general economic environments. In addition, events such as domestic and international political instability, terrorism and natural disasters may be unforeseeable and contribute to market volatility in ways that may adversely affect investments made by the Funds.

*Debt Instruments Generally.* The Funds may invest in private and government debt securities and instruments. It is likely that many of the debt instruments in which the Funds invests may be unrated, and whether or not rated, the debt instruments may have speculative characteristics. The issuers of such instruments (including sovereign issuers) may face significant ongoing uncertainties and exposure to adverse conditions that may undermine the issuer's ability to make timely payment of interest and principal. Such instruments are regarded as predominantly speculative with respect to the issuer's capacity to pay interest and repay principal in accordance with the terms of the obligations and involve major risk exposure to adverse conditions. In addition, an economic recession could severely disrupt the market for most of these instruments and may have an adverse impact on the value of such instruments. It also is likely that any such economic downturn could adversely affect the ability of the issuers of such instruments to repay principal and pay interest thereon and increase the incidence of default for such instruments.

*Fraud.* Of paramount concern in loan investments is the possibility of material misrepresentation or omission on the part of the borrower or loan seller. Such inaccuracy or incompleteness may adversely affect the valuation of the collateral underlying the loans or may adversely affect the ability of the Funds to perfect or effectuate a lien on the collateral securing the loan. The Funds will rely upon the accuracy and completeness of representations made by borrowers to the extent reasonable, but cannot guarantee such accuracy or completeness. Under certain circumstances, payments to the Funds may be reclaimed if any such payment or distribution is later determined to have been a fraudulent conveyance or a preferential payment.

*Global Investments.* The Funds may invest a portion of their assets outside the United States. In addition to business uncertainties, such investments may be affected by political, social and economic uncertainty affecting a country or region. Many financial markets are not as developed or as efficient as those in the United States, and as a result, liquidity may be reduced and price volatility may be higher. The legal and regulatory environment may also be different, particularly as to bankruptcy and reorganization. Financial accounting standards and practices may differ, and there may be less publicly available information in respect of such non-U.S. issuers.

The Funds may be subject to additional risks, which include possible adverse political and economic developments, possible seizure or nationalization of non-U.S. deposits and possible adoption of governmental restrictions which might adversely affect the payment of principal and interest to investors located outside the country of the issuer, whether from currency blockage or otherwise. Furthermore, some of the assets may be subject to brokerage taxes

levied by governments, which have the effect of increasing the cost of such investments and reducing the realized gain or increasing the realized loss on such securities at the time of sale. Income and gross sales or disposition proceeds received by the Funds from sources within some countries may be reduced by withholding and other taxes imposed by such countries. Any such taxes paid by the Funds will reduce their net income or returns from such investments.

Laws that govern private and foreign investment and transactions in financial instruments in non-U.S. countries may be relatively new and untested. As a result, the Funds may be subject to a number of unusual risks, including inadequate investor protection, contradictory legislation, incomplete, unclear and changing laws, ignorance or breaches of regulations on the part of other market participants, lack of established or effective avenues for legal redress, lack of standard practices and lack of enforcement of existing regulations. Furthermore, it may be difficult to obtain and enforce a judgment in certain non-U.S. countries in which assets of the Funds may be invested. There can be no assurance that this difficulty in protecting and enforcing rights will not have a material adverse effect on the Funds and their operations. Furthermore, it may be difficult to obtain and enforce a judgment in a court outside of the United States.

*Non-U.S. Taxation.* With respect to certain countries, there is a possibility of expropriation, confiscatory taxation, imposition of withholding or other taxes on dividends, interest, capital gains or other income or gross sales or disposition proceeds, limitations on the removal of funds or other assets of the Funds, political or social instability or diplomatic developments that could affect investments in those countries. An issuer of securities may be domiciled in a country other than the country in whose currency the instrument is denominated. The values and relative yields of investments in the securities markets of different countries, and their associated risks, are expected to change independently of each other.

*Non-performing Nature of Debt.* It is anticipated that certain debt instruments the Funds may purchase will be non-performing and possibly in default. Furthermore, the obligor or relevant guarantor may also be in bankruptcy or liquidation. There can be no assurance as to the amount and timing of payments, if any, with respect to these loans.

*Uncertain Exit Strategies.* Due to the illiquid nature of many of the positions which the Funds may acquire, as well as the uncertainties of the reorganization and active management process, Bayview is unable to predict with confidence what the exit strategy will ultimately be for any given investment, or that one will definitely be available. Exit strategies which appear to be viable when an investment is initiated may be precluded by the time the investment is ready to be realized due to economic, legal, political or other factors.

**ITEM 9**  
**DISCIPLINARY INFORMATION**

There are no legal or disciplinary events that are material to a client's or prospective client's evaluation of Bayview's advisory business or the integrity of Bayview's management.

**ITEM 10**  
**OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

**A. Broker-Dealer Registration Status**

Not applicable.

**B. Futures Commission Merchant, Commodity Pool Operator or Commodity Trading Adviser Registration Status.**

Not applicable.

**C. Material Relationships or Arrangements with Industry Participants**

Registrant's Relationship with Other Bayview Entities

The Registrant and its affiliated general partner and management company entities provide discretionary investment management services to the Funds, as more fully discussed in Item 4.

Certain inherent conflicts of interest arise from the fact that the Registrant and its Bayview affiliates provide investment management services to other investment funds, and may in the future provide investment management services to other funds, client accounts or proprietary accounts (such other funds, clients and accounts, collectively the "Other Accounts"), in which the Funds will not have an interest. The investment programs of the Funds and Other Accounts may overlap or may not be similar and Bayview may give advice and recommend securities to a Fund or an Other Account which may differ from advice given to, or investments recommended or bought for, the Funds or Other Accounts, even though their investment objectives may be the same or similar to each other. While Bayview will undertake to manage the Funds and Other Accounts diligently in pursuit of the their respective investment objectives, Bayview will devote as much of its time to the activities of the Funds and Other Accounts as it deems necessary and appropriate. When a conflict of interest arises Bayview will endeavor to ensure that the conflict is resolved fairly.

Pursuant to certain agreements between the Funds (and/or a Controlled Affiliate thereof), the Registrant and its subsidiaries (including its affiliated loan servicing company, BLS) (the "BAM Agreements"), Bayview may provide services to certain Funds with respect to: (i) sourcing investment opportunities, underwriting, and managing the purchase process for investments; (ii) servicing certain of the loans in such Funds' portfolios; and/or (iii) providing loss mitigation services and foreclosure management services to subservicers with respect to mortgage loans owned by Funds and those underlying MSRs. Such Funds will pay Bayview Acquisition Fees, Servicing Fees and Component Fees in respect of such services. In addition, as discussed more fully in Item 5C above the Funds may pay BLS Refinancing Fees and/or Facilitation Fees. The foregoing fees are in addition to and will not offset management fees or performance compensation paid or allocated to Bayview. The foregoing fees are described more fully in the confidential private placement memorandum of each Fund to which such fees apply.

The BAM Agreements have been negotiated between related parties and their terms, including fees payable, may not be as favorable to the Funds as if they had been negotiated at

arm's length with an unaffiliated third party, and may be costly and difficult to terminate. However, Bayview believes the fees to be competitive with those standard in the market.

In addition to providing services to the Funds, BLS may also do business with, and earn fees and commissions from third-parties. Notwithstanding BLS' affiliation with Bayview, BLS does not owe any fiduciary duties to the Funds. Accordingly, BLS generally will take actions in accordance with the BAM Agreements and does not have other obligations with respect to the Funds. The Funds will not be entitled to, and may not receive, any special consideration or forbearance by BLS in the exercise of its clients' rights as a result of the Funds' relationship with BLS.

#### Registrant's Relationship with Blackstone and Other Related Persons

As discussed in Item 4 above, Blackstone owns a minority interest in the Registrant. While Blackstone will not have an active role in managing the Funds, Bayview and Blackstone must agree on material changes to the policies and procedures (and any amendments thereto) governing the nature, quality, standards and other criteria for investments, as well as the use of leverage, by the Funds. Bayview will be subject to a number of actual and potential conflicts of interest involving Blackstone and its affiliates.

By virtue of its ownership interest in the Registrant, Blackstone will have access to information that investors in the Funds may not have and will be entitled to receive information regarding Bayview and its activities, including without limitation, information about the Funds' portfolios, subscriptions, withdrawals and other information relating to the Funds, as well as confidential, proprietary information about Bayview. Blackstone has implemented certain policies and procedures (e.g., information walls) to seek to ensure that the information that Blackstone receives by virtue of its ownership interest in the Registrant does not flow through the Blackstone organization.

As part of its regular business, Blackstone manages and/or advises other funds with investment objectives that overlap with the objectives of certain Funds and that may compete for investment opportunities with such Funds and may provide advice or take actions that are different or opposing to the actions taken by such Funds. Blackstone is under no obligation to resolve any conflicts arising out of its management of such investment funds or otherwise in favor of the Funds. Blackstone also provides a broad range of investment banking, advisory and other services. In the regular course of its investment banking and advisory businesses, Blackstone represents potential purchasers, sellers and other involved parties, including corporations, financial buyers, management, shareholders and institutions, with respect to transactions that could give rise to investments that are suitable for the Funds. Blackstone's clients typically require Blackstone to act exclusively on their behalf. Blackstone will not have any obligation to: (i) allocate any investment opportunities to the Funds; (ii) engage in any business exclusively through the Funds; or (iii) decline any such engagements in order to make an investment opportunity available to the Funds. For additional information regarding investments made by Blackstone that may also be appropriate for the Funds, see Item 11C below.

Bayview engaged Park Hill Group LLC, an affiliate of Blackstone and registered broker dealer ("Park Hill"), to serve as placement agent for the BOF-II Funds (which are no longer open to investment), and may engage Park Hill to serve as placement agent for Other

Accounts in the future. Management fees payable to Bayview from the BOF-II Funds are reduced on a dollar-for-dollar basis by any fees paid to Park Hill by the BOF-II Funds.

Set forth below is a list of all of the Registrant's related persons (excluding Bayview entities discussed herein) who are broker-dealers, investment advisers, commodity trading advisors and commodity pool operators. Other than as described in this Item 10C, there are no material arrangements between Bayview and such related persons at this time.

<b>Broker-Dealer</b>	
Blackstone Advisory Partners L.P.	Provides a variety of investment banking services
Park Hill Group LLC	Places alternative investment products in private offerings to mostly institutional investors
Park Hill Real Estate Group LLC	Places real estate alternative investment products in private offerings to mostly institutional investors
<b>Investment Advisers</b>	
Blackstone Advisors India Private Limited	Provides investment sub-advisory services to private investment funds
Blackstone Alternative Asset Management L.P.	Manages a series of private funds engaged in multi-manager investment programs ( <i>e.g.</i> , fund of hedge funds)
Blackstone Alternative Solutions L.L.C.	Provides investment advisory services to private investment funds which participate in a broad range of direct investment opportunities
Blackstone Clean Technology Advisors L.L.C.	Provides investment advisory services to private investment funds specializing in the cleantech energy sector
Blackstone Communications Advisors I L.L.C.	Provides investment advisory services to a private investment fund specializing in communications-related private equity investments
Blackstone Debt Advisors L.P.	Provides investment advisory services to private investment funds specializing in debt securities
Blackstone Distressed Securities Advisors L.P.	Provides investment advisory services to private investment funds specializing in distressed securities (these funds are in liquidation mode)
Blackstone Management Partners III L.L.C.	Provides investment advisory services to various private equity funds
Blackstone Management Partners IV L.L.C.	Provides investment advisory services to various private equity funds

Blackstone Management Partners L.L.C.	Provides investment advisory services to various private equity funds
Blackstone Mezzanine Advisors II L.P.	Provides investment advisory services to private investment funds specializing in mezzanine financing
Blackstone Mezzanine Advisors L.P.	Provides investment advisory services to private investment funds specializing in mezzanine financing
Blackstone Real Estate Advisors III L.P.	Provides investment advisory services to various private real estate investment funds
Blackstone Real Estate Advisors IV L.L.C.	Provides investment advisory services to various private real estate investment funds
Blackstone Real Estate Advisors V L.P.	Provides investment advisory services to various private real estate investment funds
Blackstone Real Estate Advisors L.P.	Provides investment advisory services to various private real estate investment funds
Blackstone Real Estate Advisors International L.L.C.	Provides investment advisory services to various private real estate investment funds
Blackstone Real Estate Advisors Europe L.P.	Provides investment advisory services to various real estate investment funds
Blackstone Real Estate Asia PTE Limited	Provides investment advisory services to various real estate investment funds
Blackstone Real Estate Special Situations Advisors L.L.C.	Provides investment advisory services to private investment funds which invest primarily in public and private debt and other interests of real estate assets and real estate-related holdings
Blackstone Strategic Alliance Advisors L.L.C.	Manages a series of private funds engaged in a multi-manager investment program
Blackstone Group International Partners LLP	Provides investment sub-advisory services to a number of debt-focused private investment funds
GSO / Blackstone Debt Funds Management LLC	Provides investment advisory services to a number of debt-focused private investment funds, registered investment companies and separately managed accounts
GSO Capital Partners International LLP	Provides investment advisory services to a number of debt focused private investment funds



GSO Capital Advisors LLC	Provides investment advisory services to a number of debt-focused private investment funds and separately managed accounts
GSO Capital Partners LP	Provides investment advisory services to a number of debt-focused private investment funds and separately managed accounts
Pátria Investimentos	Alternative investment management and corporate advisory firm based in Brazil
The Blackstone Group (Australia) Pty Limited	Provides investment sub-advisory services to private investment funds
The Blackstone Group (HK) Limited	Provides investment sub-advisory services to private investment funds
The Blackstone Group Japan K.K.	Provides investment sub-advisory services to private investment funds
<b>Commodity Trading Advisor &amp; Commodity Pool Operator</b>	
Blackstone Alternative Asset Management L.P.	Manages a series of private funds engaged in multi-manager investment programs ( <i>e.g.</i> , funds of hedge funds)

#### **D. Material Conflicts of Interest Relating to Other Registrants**

In addition to the relationships discussed in Item 10C above, certain Funds may also participate in pooled investment vehicles and allocate portions of their assets to unaffiliated third-party managers to manage on a discretionary basis. The Funds may be subject to various costs relating to such investments, including additional performance-based or fixed asset-based fees or allocations in addition to the fees and compensation payable or allocable to Bayview. Other than as described above, such arrangements do not give rise to any material conflicts of interest at this time.

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

**A. Code of Ethics**

The Registrant strives to adhere to the highest industry standards of conduct based on principles of professionalism, integrity, honesty and trust. In seeking to meet these standards, the Registrant has adopted a Code of Ethics (the "Code"). The Code incorporates the following general principles that all employees are expected to uphold: employees must at all times place the interests of clients first; all personal securities transactions must be conducted in a manner consistent with the Code and any actual or potential conflicts of interest or any abuse of an employee's position of trust and responsibility must be avoided; employees must not take any inappropriate advantage of their positions; information concerning the identity of securities and financial circumstances of the Funds, including the Funds' investors, must be kept confidential; independence in the investment decision-making process must be maintained at all times; and employees must comply with applicable Federal securities laws and Bayview's company policies. The Code also places restrictions on personal trades by employees that are "access persons", including that they disclose their personal securities holdings and transactions to Bayview on a periodic basis, that such employees pre-clear certain types of personal securities transactions and that all employees are prohibited from trading in "covered securities" of "restricted entities".

Investors may receive further information about the Code by contacting the Registrant at the address or telephone number listed on the first page of this document.

**B. Securities in which the Registrant or a Related Person Has a Material Financial Interest**

Certain Funds may enter into transactions and other arrangements with Bayview that may be viewed as cross or "principal" transactions. Investments may be purchased jointly by or for the benefit of one or more of the Funds and Other Accounts (whether currently in existence or formed in the future) managed by Bayview. Such investments may be initially purchased by an entity jointly owned by some or all of such investment entities before being allocated among the investment entities. Pursuant to one of the BAM Agreements, BLS may originate a new loan to a borrower to refinance an existing loan owned by one or more Funds or may accomplish modifications that result in a new loan. A Fund may purchase such loan from BLS at a price equal to the fair market value of the loan at the time of such sale or otherwise purchase assets from Bayview at fair market value from time to time. In addition, a Fund may enter into transactions and other arrangements with Blackstone that may be viewed as related-party or principal transactions. No Fund will purchase assets from Bayview (including BLS) or Blackstone unless such purchase is approved by such Fund's advisory board.

**C. Investing in Securities that the Registrant or a Related Person Recommends to Clients**

As more fully disclosed in the MSR Funds' constituent documents, Bayview may invest in certain MSRs that Bayview has determined would not be appropriate for investment by the MSR Funds pursuant to a pre-determined criteria (each, a "Bayview MSR Investment").

While each Bayview MSR Investment will, as a whole, not be appropriate for investment by the MSR Funds, due to the negotiations involved in acquiring MSRs, Bayview will have the ability to influence the mortgage loans underlying each MSR opportunity for the MSR Funds. There may be individual servicing rights within a Bayview MSR Investment that would be appropriate for acquisition by the MSR Funds. Additionally, Bayview may purchase Bayview MSR Investments from counterparties that sell MSRs to the MSR Funds, and Bayview may receive intangible benefits when transacting with such counterparties on its own behalf. Bayview intends to analyze each MSR opportunity separately, and will not price portfolios in any way that will benefit the Bayview MSR Investments to the detriment of any opportunity that is appropriate for the MSR Funds.

Under certain circumstances, the Funds may invest in financial instruments in which Blackstone has already invested or is expected to invest and in some cases, Bayview may invite Blackstone to co-invest with the Funds. In the event Blackstone is offered the opportunity to co-invest alongside the Funds, the terms with respect to such opportunity generally are expected to be similar to those applicable to the Funds (as agreed from time to time). Blackstone and the Funds generally are expected to invest and divest with respect to any such co-investment opportunities at the same time (subject to applicable tax, legal or regulatory considerations). While the foregoing should reduce potential conflicts of interest that arise in connection with shared co-investments, there can be no assurance that Blackstone will invest on the same terms, and invest and divest at the same time, as the Funds and no assurance can be made that such conflicts will not materialize. In addition, there may be certain situations where the Funds and Blackstone make separate investments in the same asset or issuer, in which case the terms of the Funds' investments, including the type of security purchased, may be different from the terms of Blackstone's investment or the type of security that Blackstone purchases (or the level at which the investment is made in an issuer's capital structure). Conflicts could arise after Blackstone on the one hand, and the Funds on the other hand, make separate investments in the same financial instrument with respect to the manner and timing of Funds' exit from the investments compared to Blackstone's exit. Should Blackstone invest in a different type of security from the security purchased by the Funds, additional conflicts may arise, particularly if the issuer experiences financial difficulties.

The Funds may also co-invest with clients of Blackstone in particular investment opportunities, and the relationship with such clients could influence the decisions made by Bayview with respect to such investments. Blackstone and other co-investors may utilize the services of Bayview affiliates in connection with such co-investments (*e.g.*, BLS), which may present additional conflicts of interest. Bayview will endeavor to ensure that any such conflict is resolved fairly.

#### **D. Conflicts of Interest Created by Contemporaneous Trading**

Participation in specific investment opportunities may be appropriate, at times, for one or more Funds. When it is determined that it would be appropriate for one or more Funds to participate in an investment opportunity, Bayview generally will seek to allocate the investment opportunity for all of the participating Funds in proportion to the relative amount of capital available for such investment opportunity by such investment accounts (*e.g.*, undrawn commitments plus investment proceeds available for reinvestment). The amount of capital available for a particular type of investment opportunity may not be 100% of such account's available capital. Bayview's investment committee will periodically determine the

percentage of each account's capital that is available for a particular type of investment opportunity based on a number of factors, including such Fund's investment program, relative exposure to various investments and the perceived relative value of the investment opportunity relative to other investment opportunities available to such Fund, and after each such determination that percentage will be the percentage used to allocate investment opportunities of that type among accounts. For instance, 100% of the BMS Funds' available capital is likely to be available for opportunities to invest in securities, while the percentage of the BOF Funds' capital available for opportunities to invest in securities is expected to vary over time.

However, Bayview, in its sole discretion, may make non-pro rata allocations among the Funds based on, among other things, Bayview's perception of the liquidity of the Funds at the time of the investment and on a going-forward basis; relative exposure to market trends; the remaining term of each such account; the terms, structure and availability of financing in respect of an investment; the geographic focus of the investment programs of the Funds and the location of the investment opportunity; and the investment programs and portfolio positions of the Funds for which participation is appropriate. For example, certain Funds are expected to invest a majority of their assets in loans and pools of loans, and Bayview may determine that an investment opportunity in another financial instrument is not appropriate for a Fund or that the opportunity should be allocated on a non-pro rata basis among the Funds based on a Fund's investment program, relative exposure to various investments and the perceived relative value of the investment opportunity (*e.g.*, Bayview may determine to allocate an opportunity to invest in asset-backed securities to an Other Account if the perceived relative value of such security is not deemed appropriate in light the Fund's investment program and its then-current portfolio).

Additionally, certain investment opportunities, although appropriate for one or more Funds, may not be divisible among multiple accounts due to, among other reasons, the small size of the opportunity or the structure of the investment. To the extent an opportunity cannot be allocated among multiple accounts, such opportunities may be allocated among the different accounts on a basis that Bayview considers fair and equitable over time, including allocating the first such opportunity to one account, the second such opportunity to another account and so on. Because Bayview may make non-pro rata allocations, the Funds managed by Bayview may produce results that are materially different. To the extent an instrument is being purchased to hedge the portfolio of one or more Funds, such instrument may not be allocated among the Funds on a pro rata basis, but instead may be allocated to the particular accounts for which the hedge is appropriate in such amounts that are deemed appropriate to hedge the particular portfolio in the sole discretion of Bayview.

## **ITEM 12**

### **BROKERAGE PRACTICES**

#### **A. Factors Considered in Selecting or Recommending Broker-Dealers for Client Transactions**

As noted previously, Bayview has full discretionary authority to manage the Funds, including authority to make decisions with respect to which securities are bought and sold, the amount and price of those securities, the brokers or dealers to be used for a particular transaction, and commissions or markups and markdowns paid. Bayview's authority is limited by its own internal policies and procedures and each Fund's investment guidelines. Portfolio transactions for the Funds are allocated to brokers and dealers on the basis of best execution and in consideration of a broker's or dealer's ability to effect the transactions, its facilities, reliability and financial responsibility and, in the case of broker-executed transactions, the provision or payment by the broker of the costs of research and research-related services which are of benefit to the Funds and Bayview. The selection of a broker (including a prime broker) to execute transactions, provide financing and securities on loan, hold cash and short balances and provide other services also may be influenced by, among other things, the provision by the broker of the following: the financial condition of the broker, diversification of counterparty risk, assessment of jurisdiction and bankruptcy laws governing the entity that holds the Funds' assets, financing terms, including length of commitment and amount and availability of financing, operational capabilities, and other factors deemed appropriate. Bayview need not solicit competitive bids and does not have an obligation to seek the lowest available commission or other transaction costs. The commissions and other transaction costs (which may include dealer markups or markdowns arising in connection with riskless principal transactions) charged to the Funds by brokers or dealers in the foregoing circumstances may be higher than those charged by other brokers or dealers that may not offer such products and services.

#### Research and Other Soft Dollar Benefits

Bayview does not currently expect that the Funds will use commission or "soft" dollars to any significant extent to pay for research products or services, given that the focus of the Funds' investment programs does not incorporate to a significant extent the types of securities trades that generate "soft" dollars that are eligible for treatment under Section 28(e) of the U.S. Securities Exchange Act of 1934, as amended. Bayview, however, reserves the right to use "soft" dollars in the future. Any such use of "soft" dollars will fall within the safe harbor for soft dollars created by Section 28(e). Under Section 28(e), research obtained with soft dollars generated by a particular Fund may be used by Bayview to service accounts other than such Fund. Where a product or service obtained with soft dollars provides both research and non-research assistance to Bayview, Bayview will make a reasonable allocation of the cost that may be paid for with soft dollars. Research products and services provided to Bayview may include research reports on particular industries and companies, economic surveys and analyses, advice from legal, strategic, financial and industry consultants and advisors, recommendations as to specific securities, and other products and services providing lawful and appropriate assistance to Bayview in the performance of its investment decision-making responsibilities. When Bayview uses client brokerage commissions (or markups or markdowns) to obtain research or other products or services, Bayview receives a benefit because it does not have to produce or pay for such products or services. Bayview may have

an incentive to select or recommend a broker-dealer based on Bayview's interest in receiving research or other products or services, rather than on its clients' interest in receiving most favorable execution.

#### Brokerage for Client Referrals

Not applicable.

#### Directed Brokerage

Not applicable.

### **B. Order Aggregation**

If Bayview determines that the purchase or sale of the same security is in the best interest of more than one Fund, Bayview may, but is not obligated to, aggregate orders in order to reduce transaction costs to the extent permitted by applicable law. When an aggregated order is filled through multiple trades at different prices on the same day, each participating Fund will receive the average price with transaction costs allocated pro rata based on the size of each Fund's participation in the order as determined by Bayview. In the event of a partial fill, allocations generally will be made on a pro rata basis on the initial order but may be modified on a basis Bayview deems appropriate, including for example, in order to avoid odd lots or de minimis allocations.

### **ITEM 13**

#### **REVIEW OF ACCOUNTS**

Bayview performs various daily, weekly, monthly, quarterly and periodic reviews of each Fund's portfolio. Such reviews are conducted by the members of Bayview's management, portfolio managers and research associates. A review of a Fund's account may be triggered by any unusual activity or special circumstances.

Investors in the Funds receive a monthly statement of account from Bayview documenting the net asset value and monthly performance of their investment in the Fund, along with unaudited financial information for the Fund, although Bayview may provide certain investors with information on a more frequent and detailed basis if agreed to by Bayview. In addition, Bayview issues investors tax reports and audited financial statements concerning their respective Funds within 120 days of the end of the Fund's fiscal year.

**ITEM 14**  
**CLIENT REFERRALS AND OTHER COMPENSATION**

**A. Economic Benefits for Providing Services to Clients**

Bayview does not receive economic benefits from non-clients for providing investment advice and other advisory services to clients.

**B. Compensation to Non-Supervised Persons for Client Referrals**

Neither Bayview nor any related person directly or indirectly compensates any person who is not a supervised person, including placement agents, for client referrals. However, Bayview has entered into a placement agreement with Lazard Freres & Co. LLC ("Lazard") in respect of the BOF-IIIa Funds, pursuant to which Lazard has agreed to introduce potential investors to the BOF-IIIa Funds. In addition, as discussed above in Item 10C above, Bayview has retained Park Hill in the past to serve as placement agent with respect to the BOF-II Funds. In the future, Bayview or a Fund may enter into arrangements with placement agents providing for payments to such agents of a one-time or ongoing fee based on a percentage of the management fee and/or incentive compensation attributable to the interests of an investor introduced by such placement agent. Management fees payable to Bayview will be reduced on a dollar-for-dollar basis by the fees paid to any placement agent by a Fund.



## **ITEM 15 CUSTODY**

Rule 206(4)-2 promulgated under the U.S. Investment Advisers Act of 1940, as amended (the "Custody Rule") imposes certain obligations on registered investment advisers that have custody or possession of any funds or securities in which any client has any beneficial interest. An investment adviser is deemed to have custody or possession of client funds or securities if the adviser directly or indirectly holds client funds or securities or has the authority to obtain possession of them (regardless of whether the exercise of that authority or ability would be lawful).

The Custody Rule imposes on advisers with custody of clients' funds or securities certain requirements concerning reports to such clients (including underlying investors) and surprise examinations relating to such clients' funds or securities. However, an adviser need not comply with such requirements with respect to pooled investment vehicles, if each pooled investment vehicle: (i) is audited at least annually by an independent public accountant, and (ii) distributes its audited financial statements prepared in accordance with generally accepted accounting principles to its investors within 120 days of its fiscal year-end. Bayview relies upon this audit exception with respect to the Funds.

## **ITEM 16**

### **INVESTMENT DISCRETION**

The Bayview entities have been appointed as the management company and/or general partner of the Funds with discretionary trading and investment authorization. Bayview has full discretionary authority with respect to investment decisions, and its advice with respect to each of the Funds is made in accordance with the investment objectives and guidelines as set forth in such Fund's respective constituent documents. Bayview assumes discretionary authority to manage the Funds through the execution of investment management agreements and through the organizational documents of the Funds (*e.g.*, limited partnership agreements).

## **ITEM 17**

### **VOTING CLIENT SECURITIES**

#### **A. Policies and Procedures Relating to Voting Client Securities**

While Bayview's investment program generally does not involve purchasing the type of investments that would require Bayview to vote proxies, Bayview has nonetheless adopted proxy voting policies and procedures in compliance with Advisers Act Rule 206(4)-6. The general policy is to vote proxy proposals, amendments, consents or resolutions (collectively, "Proxies") in a prudent and diligent manner that will serve the applicable client's best interests and is in line with each client's investment objectives. Bayview may take into account all relevant factors, as determined by Bayview in its discretion, including, without limitation: the impact on the value of the securities or instruments owned by the relevant client and the returns on those securities; the anticipated associated costs and benefits; the continued or increased availability of portfolio information; and industry and business practices. In limited circumstances, Bayview may refrain from voting Proxies where Bayview believes that voting would be inappropriate, taking into consideration the cost of voting the Proxies and the anticipated benefit to its clients. Generally, clients may not direct Bayview's vote in a particular solicitation. Conflicts of interest may arise between the interests of the clients on the one hand and Bayview or its affiliates on the other hand. If Bayview determines that it may have, or is perceived to have, a conflict of interest when voting Proxies, Bayview will vote in accordance with its Proxy voting policies and procedures. Clients may obtain a copy of the Registrant's Proxy voting policies and its Proxy voting record upon request.

**ITEM 18**  
**FINANCIAL INFORMATION**

Bayview is not required to include a balance sheet for its most recent fiscal year, is not aware of any financial condition reasonably likely to impair its ability to meet contractual commitments to clients, and has not been the subject of a bankruptcy petition at any time during the past ten years.