

Lone Star U.S. Acquisitions, LLC  
Lone Star Global Acquisitions, Ltd.

Part 2A of Form ADV  
The Brochure

2711 N. Haskell Avenue, Suite 1700  
Dallas, TX 75204  
214-754-8300  
[www.lonestarfunds.com](http://www.lonestarfunds.com)

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This brochure provides information about the qualifications and business practices of Lone Star U.S. Acquisitions, LLC, (“LSUS”), the filing adviser, and Lone Star Global Acquisitions, Ltd. (“LSGA”), the relying adviser. Together, LSUS and LSGA are referred to herein as the “Registered Advisers.” If you have any questions about the contents of this brochure, please contact us at 214-754-8300. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority.

Additional information about the Registered Advisers is also available on the SEC’s website at: [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The Registered Advisers are registered investment advisers. Registration as an investment adviser does not imply a certain level of skill or training.

**Item 2: Material Changes**

This is the Registered Advisers' initial Part 2A of Form ADV. As such, Item 2 is not applicable.

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## **Item 4: Advisory Business**

### **Background of the Registered Advisers and their Clients**

LSUS is a Delaware limited liability company, which has its principal office and place of business in the United States. LSUS was formed in 1998 as a subsidiary of LSGA. LSGA is the sole managing member of LSUS and is also an SEC-registered investment adviser.

LSGA, a Bermuda exempted company, was formed in 1998. Mr. John Patrick Grayken owns 100% of the common shares of LSGA and each General Partner (as defined below) owns a series of preferred shares of LSGA. In addition to LSUS, LSGA has several subsidiaries domiciled in non-U.S. jurisdictions, including Asia and the European Union. LSGA, LSUS and their affiliates exclusively provide investment advisory and related services to a family of privately-offered funds, generally referred to as the Lone Star Funds. LSUS and LSGA have registered with the SEC by filing a single Form ADV, and information regarding both LSUS (the filing adviser) and LSGA (the relying adviser) is included in this brochure.

Each of the Lone Star Funds is a closed-end, private equity, privately-placed limited partnership (each a “Private Fund” or “client”). Each Private Fund structure consists of a limited partnership organized in the United States under state law and a corresponding exempted limited partnership formed in Bermuda (such fund structure organization, the “U.S./Bermuda Private Funds”). When a Private Fund is investing, its U.S./Bermuda Private Funds will invest on a side-by-side basis in proportion to the respective capital commitments of each fund. The Private Funds are not registered under the Investment Company Act of 1940, as amended (“1940 Act”), or the Securities Act of 1933, as amended (“1933 Act”).

The General Partners of the Private Funds (the “General Partners”), each of which is an affiliate of the Lone Star Entities (defined below), have broad discretion under the Private Funds’ respective limited partnership agreements to manage the affairs of the Private Funds. Each General Partner on behalf of the Private Funds has granted LSGA authority to provide the services described below. In providing services to the Private Funds, LSGA relies on the resources of LSUS as well as non-U.S. subsidiaries that supply services pursuant to participating affiliate agreements (“Participating Affiliates”). LSGA’s Participating Affiliates are further discussed in Item 10. LSGA, LSUS, and the Participating Affiliates are referred to collectively in this brochure as the “Lone Star Entities.”

Hudson Advisors LLC (“HAL”), an affiliate of the Lone Star Entities and a registered investment adviser, also supplies services to the Private Funds. HAL has a subsidiary domiciled in the United States, Hudson Americas LLC (“HAM”), which is also an SEC-registered investment adviser and which also provides advisory services to the Private Funds. In addition to the services that HAL and HAM supply to the Private Funds, HAL provides services to the Private Funds through the resources of HAL’s direct and indirect subsidiaries that provide advisory services from outside the United States (also through participating affiliate arrangements). HAL, HAM and HAL’s participating affiliates are referred to collectively in this brochure as the “Hudson Entities.”

Certain employees, officers, directors, managers and consultants (“key employees”) of the Lone Star Entities, the Hudson Entities, and their affiliates are given the opportunity to invest on a side-by-side basis with the Private Funds through co-investment vehicles that are structured to facilitate those key employees’ investments (each, a “Co-Investment Vehicle”). The Co-Investment Vehicles co-invest with the Private Funds in each investment that the Private Funds acquire; the Co-Investment Vehicles do not

make any differing or separate investments from the Private Funds. The structure and operations of each Fund's Co-Investment Vehicle are discussed in Item 11.

### **Description of Services**

LSGA, either directly or through LSUS or LSGA's Participating Affiliates, provides two categories of services to the Private Funds:

- Origination services
- Investment management services

LSGA also directly provides investor relations services to the Private Funds.

### ***Origination Services***

LSGA provides origination services to each of the Private Funds. LSGA has entered into agreements with LSUS and LSGA's Participating Affiliates to assist in the provision of the origination services on a regional basis. Pursuant to its agreement with LSGA, LSUS provides origination services with respect to the Private Funds' investment activities in North America. The origination services provided by the Lone Star Entities consist of: (1) investigating and evaluating potential investment opportunities that fall within the respective Private Fund's investment strategy and objectives, as set forth in its Offering Documents (defined below); (2) providing information to the Hudson Entities, which in turn assist the Lone Star Entities in providing certain due diligence and analysis services to the Private Funds; and (3) in connection with a Lone Star Entity's recommendation to a Private Fund with respect to a potential investment, providing advice to the Private Fund on prospective joint venture partners, financing arrangements, and structuring, retention, and disposition strategies. The Lone Star Entities tailor their services to the investment strategy and objectives described in the relevant Private Fund's offering documents, including its private placement memorandum and governing documents (collectively, the "Offering Documents").

Each Private Fund may invest in a broad range of financial and other investment assets (as set forth in the Private Funds' Offering Documents). These assets include, but are not limited to:

- Equity and debt investments in distressed assets, including corporate, commercial real estate, single family residential and consumer debt;
- Real estate and real estate-related assets;
- Controlling investments in banks, operating companies and joint ventures; and
- Securitized products such as residential mortgage-backed securities ("RMBS"), collateralized debt obligations ("CDOs"), the underlying assets of which generally consist of RMBS, commercial mortgage-backed securities ("CMBS"), and other asset-backed securities.

Investment opportunities in each of these categories may be located in the U.S. or outside of the U.S., subject to certain geographical limitations of the respective Private Fund (as set forth in the Private Fund's Offering Documents). The portfolio of each Private Fund may be invested in these assets directly or indirectly through the acquisition of debt, and/or subscription of equity interests in partnerships, corporations or other entities that hold the assets (each such entity is referred to as a special purpose vehicle or "SPV").

### ***Investment Management Services***

The Lone Star Entities and the Hudson Entities provide coordinated investment management services to the Private Funds. LSUS provides investment management services in North America. After a Lone Star Entity has identified a potential investment opportunity that falls within the respective Private Fund's investment strategy and objectives, and after the Lone Star Entity and the applicable Hudson Entity have conducted due diligence and analysis on the potential investment, the Lone Star Entity (often assisted in specific aspects by the respective Hudson Entity) prepares an Investment Committee Memorandum with detailed information regarding the potential investment. The Lone Star Entity then presents the investment opportunity to the Investment Committee at LSGA responsible for the relevant Private Fund that is currently in its investment period (the "Investment Committee"). With respect to each of those Private Funds, the Investment Committee is composed of (i) Mr. Grayken, (ii) the General Counsel of the Lone Star Funds, and (iii) the three principals of the Lone Star Entities who oversee their respective regional operations of the Lone Star Entities (each a "Region Head"). The members of each Investment Committee are supervised persons of LSGA. The Investment Committee reviews the recommendations of the Lone Star Entity and, if the Investment Committee approves such recommendations, the relevant Private Fund makes the investment.

Once an investment has been approved by the Investment Committee and implemented for a Private Fund, the relevant Hudson Entity typically develops an initial business plan for the ongoing management of the investment, consistent with the Investment Committee Memorandum (each, a "Business Plan"). Ongoing day-to-day asset management of each investment is performed by the relevant Hudson Entity. The Region Heads periodically review the implementation and ongoing validity of the Business Plan; this review process is discussed in Item 13. The Lone Star Entities also provide strategic and other related advice regarding investments held by the Private Funds.

### ***Investor Relations Services***

LSGA also provides investor relations services related to the general investment advisory services provided to the Private Funds. These services include: (1) assisting the General Partner of each Private Fund with regard to the identification of prospective investors for the Private Fund; (2) corresponding with, and providing information to, existing and prospective investors in the Private Funds; (3) upon a General Partner's request, providing financial and other information to the General Partner regarding existing and prospective investors of which LSGA is or becomes aware; and (4) upon a General Partner's request, making itself and its employees, contractors and other agents reasonably available to the General Partner to the extent appropriate, to assist the General Partner in fulfilling its obligations to the Private Funds.

### **Wrap Fee Programs**

The Registered Advisers do not participate in wrap fee programs.

### **Assets under Management**

As of September 30, 2011, the most recent date such information is available, the Registered Advisers provided origination and investment management services involving a significant amount of investment discretion with respect to \$32,184,079,785 in assets and unfunded commitments of the Private Funds.

## **Item 5: Fees and Compensation**

The General Partner of each of Lone Star Fund III, Lone Star Fund IV, Lone Star Fund V, Lone Star Fund VI, and Lone Star Real Estate Fund has instructed the relevant Private Fund to pay the General Partner's management fee (the "Management Fee") to LSGA for LSGA's services. Each of Lone Star Fund VII and Lone Star Real Estate Fund II pays the Management Fee directly to LSGA. The Management Fees are payable out of funds of the Private Funds or pursuant to capital calls on the limited partners' unfunded commitments and are payable monthly in arrears during the commitment period of a Private Fund, and quarterly in arrears thereafter. The Management Fee is based on unreturned commitments prior to the close of the commitment period (i.e., the period during which the General Partner may call capital for new investments from limited partners) and upon the termination of the commitment period, the Management Fee is calculated as a percentage of outstanding capital contributions by the Private Funds' limited partners. Outstanding contributions are calculated on an investment-by-investment basis and remain outstanding until the specific investment has realized a profit or been written down. A limited partner may have outstanding contributions for a particular investment that has not yet realized a profit or been written down even though the limited partner may have received distributions from the Private Fund that total more than its aggregate capital contributions to the Private Fund. The Management Fees after the commitment period for Lone Star Fund III and Lone Star Fund IV generally range from 0.50% to 0.70% of outstanding contributions. Because Management Fees are based on outstanding capital contributions after the close of commitment periods, the Private Funds and their limited partners continue to pay a Management Fee with respect to each investment that has not realized a profit or been written down. Accordingly, a lower aggregate Management Fee will likely be paid with respect to an investment that quickly realizes a profit than for an investment of similar size that does not realize a profit quickly, or ever. The limited partners of Private Funds other than Lone Star Fund III and Lone Star Fund IV include only "qualified purchasers," as that term is defined in Section 2(a)(51) of the 1940 Act. Accordingly, the Management Fees of those Private Funds are not disclosed herein.

The Registered Advisers do not receive fees in advance from any client. The Co-Investment Vehicles do not pay any fees to the Registered Advisers. Neither the Registered Advisers, nor any of their supervised persons receive compensation for sales of Private Fund or Co-Investment Vehicle interests, or any other securities or investment products.

HAL provides, either directly or indirectly through one or more of the Hudson Entities, asset management services to the Private Funds and the SPVs for a fee based on a percentage of assets under management. In addition, HAL provides, either directly or indirectly through one or more of the Hudson Entities, due diligence and analysis, hedging, and other ancillary services for a fee based on the actual time incurred to provide those services plus a specified margin. Typically, the Hudson Entities' fees are billed to the applicable Private Fund and/or SPV and are payable on a monthly basis in arrears. The Hudson Entities do not bill in advance and, therefore, do not have refund procedures. To the extent not paid by the Private Funds or the SPVs directly, the Private Funds reimburse the Hudson Entities for out-of-pocket third party expenses, charges incurred in connection with the custody of investments, outside legal and accounting fees and other non-recurring and extraordinary expenses.

Certain expenses shared by one or more Private Funds may be paid by a single Private Fund, which is reimbursed by other Private Funds for their appropriate share of the relevant expenses. In such cases, HAL has implemented procedures designed to ensure that such allocations are based on a sound method whereby shared expenses are reimbursed to the Private Fund that paid them in the proper amount.

All of the Private Funds generally bear all expenses related to their operations, including broker's commissions, clearance charges, due diligence expenses, loan servicing fees, travel expenses, taxes, other

expenses incident to the purchase and sale of investments by such Private Fund, charges incurred in connection with the custody of investments, outside legal and accounting fees and other nonrecurring and extraordinary expenses. Item 12 discusses the Lone Star Entities' practices for choosing brokers and certain other counterparties.

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

The Lone Star Entities do not receive any performance-based fees. The General Partner of each Private Fund receives a "carried interest," which is a certain percentage of the actual returns in excess of certain performance hurdles of each investment made by the relevant Private Fund. The amount of carried interest may change over time based on the performance of the Private Fund's investments and may be considered a performance-based fee. The General Partner will be entitled to receive its "carried interest" at the appropriate payment level within such Private Fund's distribution hierarchy (i.e., waterfall), which is set forth in the Private Fund's limited partnership agreements. Payment of the General Partner's carried interest will generally occur on an investment-by-investment basis after all capital contributed for such investment is returned and a specific preferred return on such investment is realized and paid to the relevant Private Fund's limited partners.

Certain supervised persons of the Registered Advisers are limited partners of, or have other ownership interests in, one or more of the General Partners, and may, therefore, receive a portion of the "carried interest." This fee arrangement could create an incentive for these supervised persons when allocating investment opportunities to favor a Private Fund that pays higher fees over a Private Fund that pays lower fees. The Registered Advisers believe, however, that there are safeguards in place that protect against this circumstance. The Private Funds have typically been structured such that only one Private Fund is investing in a particular asset class at any given time. When two Private Funds are investing at the same time, the limited partnership agreement of each of the Private Funds specifies the types of eligible investments that each of these Private Funds may make without overlap between such funds. Such safeguards are further discussed in Item 11.

## **Item 7: Types of Clients**

### **Private Funds**

The Registered Advisers provide investment advisory services to the Private Funds, and consider the Private Funds, and not the investors in the Private Funds, to be their clients. Each Private Fund sets its own minimum investment requirements for investors, which is generally ten million U.S. dollars. The General Partner of a Private Fund may, in its sole discretion, waive the investment minimum.

Each investor participating in the Private Funds is generally required to meet certain suitability and net worth qualifications applicable to the respective Private Fund, i.e., the investor must be an "accredited investor" within the meaning of Rule 501 of Regulation D promulgated under the 1933 Act, and, with respect to the Private Funds other than Lone Star Fund III and Lone Star Fund IV, also must be a "qualified purchaser" as defined in Section 2(a)(51) of the 1940 Act.

### **Co-Investment Vehicles**

As noted in Item 4, the Co-Investment Vehicles invest on a side-by-side basis with the Private Funds in the same investment opportunities identified by the Lone Star Entities for the Private Funds. The Registered Advisers do not consider the Co-Investment Vehicles to be their clients.

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

LSGA provides, directly and through LSUS and LSGA's Participating Affiliates, origination and investment management services to the Private Funds. The origination services include identifying, analyzing and making recommendations with respect to potential investments. The Hudson Entities assist the Lone Star Entities in performing the origination services by conducting due diligence and analysis on potential investment opportunities.

The Lone Star Entities and the Hudson Entities provide coordinated investment management services to the Private Funds. The investment management services provided by the Lone Star Entities include the preparation of Investment Committee Memoranda for consideration by the Investment Committees responsible for the respective Private Funds that are currently in their investment periods, ongoing strategic review of the performance of assets held by the Private Funds, and the provision of strategic and other related advice regarding investments held by the Private Funds. The Hudson Entities have primary day-to-day responsibility for the management of assets held by the Private Funds.

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

#### ***Investment Strategies***

The Lone Star Entities will utilize the investment strategies described in the relevant Private Fund's Offering Documents, which include, but are not limited to, investing in: (1) equity and debt investments in distressed assets, including corporate, commercial, and single family residential real estate, and consumer debt; (2) other real estate and real estate-related assets; (3) controlling investments in banks, operating companies and joint ventures; and (4) securitized products such as RMBS, CDOs, the underlying assets of which generally consist of RMBS, and CMBS. Each Private Fund may use a substantial amount of direct or indirect leverage in connection with its investments. In the application of these investment strategies, a Lone Star Entity will identify and recommend financing strategies for certain potential investments consistent with the Private Fund's Offering Documents. The Lone Star Entities typically recommend financing strategies on an investment-by-investment basis, and these recommendations are typically incorporated into the origination and investment management services provided with respect to each investment.

#### ***Methods of Analysis – Identification and Initial Due Diligence***

To identify potential investment opportunities for the Private Funds, the Lone Star Entities monitor the U.S. and non-U.S. markets for potential sales of the various types of assets that the Private Funds purchase. Typically, the Lone Star Entities will seek potential investment opportunities from institutions such as banks or corporate sellers. The investment professionals at the Lone Star Entities responsible for the origination of these prospective investment opportunities rely on their experience in various asset markets and significant knowledge of those markets, along with new and existing relationships with many of the potential counterparties in those markets, to identify potential investment opportunities. The Lone Star Entities' initial due diligence and analysis generally includes assessment of current and future market conditions for specific assets, assessment of asset sellers and other counterparties, and identification of available financing opportunities from counterparties and third parties. When considering whether, and in what manner, a potential investment opportunity should be financed, the Lone Star Entities may consider, among other things, the availability of financing opportunities, the cost of each opportunity, the duration of the financing, the relevant risks of each opportunity, and whether such financing is likely to be obtained, and obtained in a timely fashion. The Lone Star Entities also conduct initial analysis through discussions and meetings with potential counterparties and relevant third parties, on-site inspections of



physical properties (where applicable), and review of financial reports and other data made available by counterparties and relevant third parties.

Once a Lone Star Entity has identified and conducted initial due diligence and analysis on an investment opportunity, and determined to move forward with the potential investment, it works with a Hudson Entity to conduct more extensive due diligence and analysis on a potential investment. Typically, the Hudson Entity will review information regarding the potential investment and conduct more extensive due diligence and analysis on the potential investment. In providing these services, the Hudson Entity uses various methods of analysis, which utilize proprietary and third-party data, and are tailored to the type of potential investment being evaluated. The Lone Star Entity relies on the due diligence and analysis materials generated by the Hudson Entity to help determine whether to recommend that a Private Fund make the potential investment.

If the Lone Star Entity decides, based on the due diligence and analysis described above, that a Private Fund currently in its investment period should acquire the relevant investment, it makes its recommendation to the Investment Committee in the form of an Investment Committee Memorandum. The Lone Star Entity will include any financing recommendations in the Investment Committee Memorandum, however, exact financing terms may not be known prior to Investment Committee approval. The Investment Committee must approve the potential investment before the Private Fund makes the investment.

#### ***Methods of Analysis – Residential Mortgage-Backed Securities***

In evaluating investments related to residential mortgage-backed securities and CDOs backed primarily by mortgage-backed securities, the Lone Star Entities rely on analysis provided by the Hudson Entities. The Hudson Entities use a third-party system that includes a loan-level model that assigns the probability of future defaults, prepayments and loss severities to the underlying loan collateral. The model considers, among other factors, borrower characteristics and the particular attributes of the loans underlying the securities, as well as projected future prices of residential real estate and interest rates. The resulting projections of future loan performance derived from the loan-level model are then applied to the mortgage-backed security's payment hierarchy (i.e., waterfall), and the projected cash flow of the security being valued is extracted. In the case of a CDO, the Hudson Entities then assign the cash flow from each security backing the CDO to the CDO's waterfall and extract the projected cash flow of the CDO. The Hudson Entities also evaluate the resulting prepayment, default and severity assumptions under more stressful scenarios to account for macroeconomic uncertainty and various residential real estate price depreciation paths.

When valuing mortgage-backed securities and CDOs, the Hudson Entities use market information such as residential real estate price depreciation, rent, replacement costs, new and existing property sales and data from loan servicers regarding modifications. Additionally, the Hudson Entities evaluate data from vendors including CoreLogic, Intex, and Bloomberg, as well as public data from trustees and servicers.

#### ***Methods of Analysis – Corporate Equity and Bonds***

In evaluating investments related to corporate equity and bonds, the Hudson Entities use a combination of the discounted cash flow method and the company's multiple method (i.e., price-to-earnings, price-to-books, EBITDA, etc.). The Hudson Entities also project the future performance of the company under evaluation (including liquidation value as necessary), which the Hudson Entities calculate using the company's financial statements, credit, business plans, material agreements and other information. In the analysis conducted for corporate bonds, if a Hudson Entity determines that the company might not survive, it calculates the liquidation value of the company and determines the price of the bond based on

that liquidation value. If the Hudson Entity determines that the company should survive up through the maturity of the subject bond, then it typically determines the bond price by discounting the contractual repayment schedule (although the Hudson Entity may, as an alternative scenario, determine the price of the bond based on the company's liquidation value). The Hudson Entities also run sensitivities on a range of financial variables to comprehend the effects on returns.

### ***Methods of Analysis – Whole Loans***

In evaluating investments related to whole loan assets (including small-medium enterprise loans, leveraged buyout loans, retail (consumer finance) loans and non-performing mortgage loans backed primarily by residential properties, but excluding commercial real estate-secured loans), the Hudson Entities use a loan-level model that generates and projects loan level cash flows taking into account the borrower's credit profile and, if applicable, the projected cash flows of the underlying collateral under various probability-weighted liquidation scenarios.

For loans secured by property, the model considers the underlying property's updated value analyzed using traditional residential real estate valuation methods including, among other methods, the comparable sales approach, broker price opinions and automated valuation models. After establishing the current value of the underlying property, the model considers future price projections based on the property's specific geographical area and property type. Additionally, advance balances, foreclosure timelines, property marketing timelines, and various liquidation expenses are factored into the model assumptions. When valuing these loans, the Hudson Entities also use internally sourced market information, such as home price depreciation reports and sales reports, as well as real-time empirical data from a related captive loan servicer regarding modifications and liquidation strategies.

When valuing retail (consumer finance) loans, the Hudson Entities utilize a third-party financial technology firm that specializes in the valuation of these loan portfolios. The Hudson Entities forecast future cash flows from the retail loans using the valuation results generated by the third-party firm.

For all of the whole loan assets, the Hudson Entities stress test the resulting cash flow projections to account for various factors including macroeconomic uncertainty, various price depreciation paths, and asset management strategies.

### ***Methods of Analysis – Commercial Real Estate Assets***

The Hudson Entities use similar methods of analysis and investment strategies for CMBS, commercial real estate loans and commercial real estate properties. The Hudson Entities first analyze the property itself by employing traditional real estate valuation methods, including the comparable sales approach, the income approach, the replacement cost approach and the development approach. Each of these methods entails a detailed analysis of the particular markets and attributes of the particular investment, including location, structural and environmental characteristics and current and forecasted demographic characteristics. Additionally, the Hudson Entities have developed a model that incorporates the information from the methods noted above and aggregates the information to evaluate potential commercial real estate investments in whole loans, structured loans or securitized mortgages.

As part of their evaluation of whole loans and CMBS, the Hudson Entities review the underlying collateral and conduct a fundamental analysis and valuation of the collateral. The Hudson Entities evaluate data from vendors including CoreLogic, Intex, and Bloomberg as well as public data from trustees and servicers. The Hudson Entities also use third-party analysis solutions to perform necessary analytics. The Hudson Entities utilize the Bloomberg application to obtain the latest

market pricing of certain securities, interest rate curves, interest rate projections by market participants, and general sentiments regarding market pricing. For real estate, the Hudson Entities also evaluate real time empirical data. The Hudson Entities cultivate relationships with a network of local sales/leasing brokers and real estate developers who are knowledgeable regarding the local market. Additionally, the Hudson Entities run sensitivity analyses to comprehend the effects of alternative market assumptions should events turn out differently than projected.

### ***Methods of Analysis – Hedging Services***

The Private Funds have numerous investments in entities located in various countries that are exposed to volatility in currency exchange rates. In addition, the Private Funds' investment strategies are exposed to interest rate risk. The Private Funds maintain an overall foreign currency and interest rate risk management strategy that incorporates the use of derivative instruments in an effort to minimize significant unplanned fluctuations in earnings caused by foreign currency and interest rate volatility. HAL, with input from the relevant HAL Entity and Lone Star Entity primarily responsible for asset management and origination of that investment, will determine the hedging strategy for the investment, and may elect to not fully hedge the currency risk or interest rate risk associated with the investment. HAL will then implement the hedging strategy. HAL implements the Private Funds' hedging activities through a variety of derivatives. In connection with non-U.S. dollar denominated investments by the Private Funds, HAL typically uses forward foreign exchange contracts and foreign currency options to manage the foreign currency exposure associated with such investments. Additionally, if an investment has interest rate exposure, HAL typically uses interest rate swaps and interest rate options to manage the exposure.

### **Risks**

All investments involve the risk of loss that the Private Funds and their underlying investors should be prepared to bear. A more detailed discussion of the risks relating to an investment in one of the Private Funds can be found in the Private Fund's Offering Documents.

### ***Material Risks Relating to Investment Strategies***

**Opportunistic Investment Strategy.** The Private Funds make opportunistic investments within the scope of the investment program set out in the Offering Documents. The opportunistic investment strategy utilized by the Lone Star Entities on behalf of the Private Funds generally does not incorporate consideration of other investments held in the investment portfolio. Accordingly, portfolio risk controls such as investment diversification or avoidance of risk concentration at the investment portfolio level are typically not considered when assessing the merits of a potential investment. Instead, the Private Funds' opportunistic investment strategy focuses on the expected returns of each potential investment on an individual basis. This opportunistic investment strategy may result in a significantly elevated risk profile of the Private Funds compared to a strategy that actively diversifies investments across type, sector, location, and/or other risk factors.

**Limited Number of Investments.** As a result of the Private Funds' opportunistic investment strategy, they may participate in a limited number of investments or a limited number of asset classes and, as a consequence, the aggregate return of the Private Funds may be substantially adversely affected by the unfavorable performance of a single investment or a single asset class. In addition, the diversification of the Private Funds' investments could be further limited and proportionately more capital employed to the extent a Private Fund invests a significant portion of its capital in a single transaction, a limited number of transactions, a single asset class, or a limited number of asset classes.

**Investing in Troubled Assets.** Investments in secured and unsecured non-performing loans or other troubled assets involve a significant degree of legal and financial risk and, particularly in the international context, political risks. Furthermore, investments in assets operating in workout modes or under bankruptcy reorganization laws may, in certain circumstances, be subject to certain additional potential liabilities that may exceed the value of the Private Funds' original investment. Moreover, particularly with respect to international investments in troubled assets, there are additional risks and uncertainties related to litigation, bankruptcy, and other laws and regulations affecting the rights and remedies of the Private Funds, which can create additional financial risks.

**Risks of Investing in Real Estate-Related Assets.** Investments in real estate assets and real estate-related assets are subject to various risks associated with the real estate industry generally, including adverse changes in the financial conditions of tenants, buyers, and sellers of properties; the availability of financing; real estate tax, interest rates and other operating expenses; insurance; environmental laws and regulations, zoning laws, and other governmental rules and fiscal policies; the relative popularity of certain property types and locations; and the availability of certain construction materials. Developments in global and local financial and real estate markets over the past few years, and new developments in those markets, if they occur, may result in reductions in the value of real property interests. The real estate assets associated with the Private Funds' investments may be or become non-performing after acquisition for a wide variety of reasons. Such non-performing real estate investments may require a substantial amount of workout negotiations and/or restructuring, which may entail, among other things, a substantial write-down of such loans or assets.

**Risks of Investing in Commercial Mortgage Loans.** The value of the Private Funds' commercial mortgage loans and CMBS will be influenced by the historical rate of commercial mortgage loan delinquencies and defaults and by the severity of resulting losses. Commercial mortgage loans are generally viewed as exposing a lender to 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 rather than upon the borrower's other income or assets, as most commercial mortgage loans provide recourse only to the property itself.

**Credit Risks.** A Private Fund's investment could lose money if the issuer or guarantor of a fixed income security is unable or unwilling, or is perceived by market participants, ratings agencies, pricing services or others, as unable or unwilling to make timely principal and/or interest payments, or to otherwise honor its obligations. Securities are subject to varying degrees of credit risk, which are often reflected in their credit ratings. The downgrade of the credit of a security held by a Private Fund may decrease its value. "Distressed" assets are generally considered to have significant credit risk. With respect to the financing strategies and hedging services described above, the Private Funds may also be subject to the risk that a counterparty to a financing arrangement or derivatives contract may be unable or unwilling to honor its obligations as a result of the counterparty's financial condition or insolvency.

**Mortgage-Backed Securities.** In general, risk factors discussed herein pertaining to mortgage loans (and the type of property securing such mortgage loans), would similarly pertain to any mortgage-backed security in which the Private Funds invest. Some or all of the potential mortgage-backed securities to be acquired by the Private Funds may not be rated, or may be rated lower than investment grade by one or more nationally recognized statistical rating organizations. The majority of the mortgage-backed securities acquired by the Private Funds are typically lower-rated or unrated, and the original ratings of many of these securities were withdrawn or downgraded to levels that are significantly below investment grade. Lower-rated or unrated mortgage-backed securities in which the Private Funds may invest have speculative characteristics that can involve substantial financial risks. Securities rated lower than "B" 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 Private Funds from loss. If the Private Funds invest in subordinated mortgage-backed securities in particular, the Private Funds will be first in line among debt holders to bear the risk of loss from collateral delinquencies and defaults.

**International Investing.** The Lone Star Entities perform services for the Private Funds on a global basis, and in particular, in North America, Europe and Asia. Risks to the Private Funds' investments may result from differences between U.S. and Non-U.S. countries, such as the absence of uniform accounting, auditing, and disclosure requirements; less government oversight and other legal and regulatory differences, including weaker investor protections and fiduciary duties; less advanced bankruptcy laws; and difficulty in enforcing contractual obligations. Further risks may involve a country's potential economic, political, or social instability, which can lead to expropriation or confiscatory taxation, higher inflation, nationalization, war and can necessitate an investor's reliance on a country's diminished economic and physical infrastructure to support investment activity. Such instability may also lead to fluctuations in currency exchange rates that affect the value of the Private Fund's investments, and foreign currency and other restrictions imposed to prevent capital flight, which may make it difficult or impossible to exchange or repatriate foreign currency.

The Lone Star Entities will analyze risks in the applicable countries before making investments therein, but no assurance can be given that a country's political, social or economic climate, or particular tax, legal, or regulatory risk might not adversely affect an investment by the Private Funds. HAL, on behalf of the Private Funds, will also attempt to maintain a "currency neutral" position for the Private Funds by hedging, directly or indirectly, certain currency risks. However, HAL's currency hedging procedures are conducted only as an attempt to minimize or reduce risk, and there can be no assurance that such hedges will be available, be available at a reasonable cost, or be sufficient to actually eliminate the risk of fluctuations in currency exchange rates. Despite efforts by the Lone Star Entities and HAL to mitigate some of the foregoing risks, these risks may ultimately limit the Private Funds' ability to dispose of certain investments or to dispose of certain investments profitably.

**Investments in Finance Companies, Banks, Bank Holding Companies and other Regulated Financial Institutions.** Finance companies, banks, bank holding companies and other regulated financial institutions operate in highly competitive environments and are subject to extensive regulation. These institutions compete against one another for loans, deposits, and other financial services. The Private Funds may invest in finance companies that may be subject to a larger degree of governmental regulatory oversight and periodic examination than their competitors. Investments in institutions that provide secured and unsecured loans are highly speculative and subject to various risks, including adverse changes in national or international economic conditions; adverse local market conditions; changes in availability of debt financing; changes in interest rates, governmental rules, and fiscal policies; risks due to dependence on cash flow; risks and operating problems arising out of acts of God; uninsurable losses; and other factors that are beyond the control of the Registered Advisers.

**Financing and Use of Leverage.** The Private Funds' ability to achieve or surpass target rates of return on the investments recommended by the Lone Star Entities may depend on the ability to access sufficient financing sources on desirable terms. The Private Funds' investments are typically financed by initially borrowing under the lines of credit of such Private Funds and/or third party financings typically at the SPVs. This leverage will increase the exposure of such investments to adverse economic factors such as significantly rising interest rates, increased risk spreads, severe economic downturns or deterioration in the condition of the investment or its corresponding market. Generally, the presence of leverage in the Private Funds' portfolios will magnify their volatility and may substantially increase the Private Funds' risk profile. In the event a specific investment is unable to generate sufficient cash flow to meet principal and interest payments required to maintain the financing arrangements related to that investment, the

value of a Private Fund's equity position in that investment could be significantly reduced or even eliminated.

The Private Funds use a variety of financing sources including, without limitation, bank loans and repurchase agreements. The repurchase agreements used by the Private Funds for financing purposes may have various terms ranging from a month or less to over a year. In the event that any given financing arrangement is terminated prior to its expected term, the Private Funds may not be able to refinance the underlying investment in a timely manner, or on the same terms as the prior financing arrangement, or on any terms.

In addition to the enhanced portfolio volatility and risk that may arise from the use of leverage, each financing instrument is subject to credit risk with respect to the counterparty. Financing transactions typically involve the transfer of legal title, pledge, or other encumbrance of the underlying investment of the Private Fund. Accordingly, the insolvency or bankruptcy of a financing counterparty may result in legal action that impairs the value or marketability of the underlying investment, or the Private Fund's ownership rights. There can be no assurance that the Private Fund will recover all or any of the economic value of the investment under such circumstances, and any such recovery may require the payment of substantial legal costs.

**Illiquidity of Investments.** Most private equity investments are highly illiquid, and there can be no assurance that the Private Funds will be able to realize these investments in a timely manner. It is unlikely that there will be a public market for most of the investments held by the Private Funds. The Private Funds generally will not be able to sell securities held in their investment portfolios publicly unless their sale is registered under applicable securities laws, or unless an exemption from such registration requirements is available. In some cases the Private Funds may be prohibited by contract from selling investments for a period of time. In addition, the types of investments held by the Private Funds may be such that they require a substantial length of time to liquidate. In the event of a margin call or other loan repayment at a time in which a Private Fund does not have sufficient cash assets to cover such call or payment, the Private Funds may have to liquidate certain investments at less than their expected returns, thereby resulting in lower realized proceeds to the Private Funds.

### ***Material Risks of Loss Related to Methods of Analysis***

#### **Risks Related to the Lone Star Entities' Methods of Analysis**

The Lone Star Entities seek to perform reasonable and proper due diligence and analysis on each prospective investment, in an effort to identify, based on relevant facts and circumstances, investment opportunities and possible risks related to those opportunities. In conducting research and analysis, the Lone Star Entities will depend on available resources, including the investment counterparty, and possibly other third parties involved in a potential investment transaction. The Lone Star Entities will also depend on and utilize the Hudson Entities and their methods of analysis, described above. The methods of analysis that the Lone Star Entities employ, including those methods used by the Hudson Entities, when determining whether to recommend that a Private Fund make a particular investment, may be subjective and cause the Private Funds to lose money over short or long periods. As a result, as well as due to other risks inherent in investments generally, there can be no assurance that the Lone Star Entities' recommendations will satisfy the investment objectives of any particular Private Fund or that any Private Fund will be able to carry out its investment strategy successfully.

Investment analyses and decisions by the Lone Star Entities may frequently be required to be undertaken on an expedited basis to take advantage of investment opportunities. In such cases, the information available to a Lone Star Entity at the time of an investment decision may be limited, and the Lone Star

Entity may not have access to detailed information regarding the opportunity, such as physical characteristics, structural or environmental matters, zoning regulations, or other local conditions affecting an investment. With respect to real estate-related investments, the Lone Star Entities may not be able to undertake all appropriate inquiries into the previous ownership and uses of a property consistent with typical commercial or customary practice. Therefore, no assurance can be given that the Lone Star Entities will have knowledge of all circumstances that may adversely affect an investment. In addition, the Lone Star Entities may rely upon independent consultants in connection with its evaluation of proposed investments; however, no assurance can be given that these consultants will accurately evaluate such investments, and the Private Funds may incur liability as a result of such consultants' actions.

Risks related specifically to the Hudson Entities' methods of analysis are discussed below.

#### Risks Related to the Hudson Entities' Methods of Analysis

**Analysis of Securities.** The material risks related to valuing mortgage-backed securities and CDOs backed primarily by mortgage-backed securities, using a credit-based model, include: (1) changes affecting the model inputs used to project performance (such as prepayment speeds, delinquency rates, loss severities and interest rate assumptions); and (2) the potential for new variables (such as foreclosure moratoriums, new governmental programs or legislative or regulatory changes) to impact actual performance. To address these risks, the Hudson Entities perform regular model validation tests and adjust the models to account for changes in the market, including credit trends, servicing trends and legislative and regulatory developments.

Other material risks related to valuing mortgage-backed securities and CDOs include events that either diminish the total recovery amount on the underlying asset or significantly extend the timing of collection of such recovery amount from the sale of the underlying property. To assess these risks, the Hudson Entities perform multi-scenario valuations (including what the Hudson Entities believe to be stress-case valuations) in an attempt to determine potential downside risks of the investment.

These securities also carry the risk of document ambiguities, errors or omissions. Additionally, investments in CDOs include the risk of potential conflicts of interest among the holders of various classes of notes of the CDO. To help mitigate these risks, the Hudson Entities work with internal counsel and, when appropriate, engage external counsel to review associated documents and evaluate these potential risks.

**Analysis of Whole Loan Assets.** The material risks related to valuing loans include: (1) changes affecting the model inputs used to project loan performance; and (2) the potential for new variables to significantly impact the likelihood of loan repayment. To address these risks, the Hudson Entities perform periodic model validation tests and adjust the models to account for changes in the market, including housing trends. The Hudson Entities perform multi-scenario valuations in an attempt to assess downside risk. Non-performing residential mortgage loans also have increased risk of litigation in connection with the foreclosure process. To help mitigate this risk, the Hudson Entities engage third-party due diligence vendors to review a sample of loans purchased.

**Analysis of Commercial Loan Assets.** The material risks related to valuing CMBS, commercial real estate loans and properties include: (1) changes affecting the model inputs used in the valuations; and (2) the potential for new variables to significantly impact the ability to realize a profit on the investment. To assess these risks, the Hudson Entities use on-going surveillance of the market to adjust the model for a particular investment, and perform multi-scenario valuations in an attempt to assess downside risk. Commercial real estate loans and properties also have increased risk of litigation in connection with the

foreclosure process. To help mitigate this risk, the Hudson Entities engage third-party due diligence vendors to review a sample of loans purchased.

**Hedging Services.** Although HAL employs hedging strategies for the Private Funds, there is no assurance that foreign exchange risk and/or interest rate risk can be perfectly hedged or minimized where the magnitude and timing of future cash flows can only be estimated and not known with certainty. Thus, prudent currency and interest rate hedging policies only serve to minimize or reduce these risks, but not to eliminate them completely. There can be no assurance that a client will have sufficient liquidity or credit capacity to support the hedging services provided by HAL, and no assurance that hedging techniques will be available, be available at a reasonable cost, or be sufficient to eliminate these risks. In addition, HAL, together with the relevant HAL Entity and Lone Star Entity primarily responsible for asset management and origination of an investment, may elect to hedge the investment's currency or interest rate exposure at an amount less than the expected value of that investment. In such cases, a client may suffer losses from changes in foreign exchange rates or interest rates that may have been recouped through hedging transactions if the investment had been fully hedged. In addition, counterparty defaults within the market generally have increased in recent years and may continue to increase, and there exists a risk that any counterparty to a hedging transaction will not perform as expected. There may also be complications in the enforcement of hedging transactions in the event of partial or total dissolution of a currency block such as the Euro, the imposition of currency controls, or similar currency market disruption to a hedged currency, and litigation between the Private Funds and the hedging counterparty may result from such complications. Such a disruption to the currency markets may also cause HAL to be unable to implement hedging transactions in the affected markets for an indefinite period of time.

### ***General Risk Factors***

**Market Risks.** The Private Funds may have some investments that are publicly traded or traded in active private markets. The values of such investments are particularly susceptible to fluctuations based on market trends. Global financial markets have experienced a variety of difficulties and changed economic conditions over the past several years. In particular, economic and financial conditions in the global markets have deteriorated substantially with significant declines in global financial markets in equity and debt securities valuations, sharply diminished access to credit, and the breakdown of important financial institutions. Certain worldwide government bodies and central banks have responded with extraordinary intervention programs, the success of which has yet to be measured. As a result, credit availability has contracted and financing costs have increased, which have acted as barriers to new, sizeable, leveraged transactions. This reduced (or more expensive) credit availability along with equity and debt security valuation declines has negatively impacted the private equity sector. Further changes in stock prices, interest rates, currency exchange rates, or commodity prices could result in changes in the broader marketplace that adversely affect the value of publicly traded investments, particularly with respect to investments located in emerging markets or traded on relatively volatile exchanges. The Private Funds, at the recommendation of a Lone Star Entity, may invest in publicly traded securities on markets that are relatively illiquid or volatile. The values of such investments are particularly susceptible to fluctuations based on market trends. The Private Funds may have difficulty disposing of such investments at a price and on terms that are attractive to the Private Funds.

**Currency Risk.** The Private Funds may make investments in assets denominated or valued in non-U.S. currencies. Exchange rates for non-U.S. dollar currencies relative to the U.S. dollar may fluctuate significantly over short and long periods of time for a number of reasons, including changes in interest rates, intervention (or the failure to intervene) by U.S. or non-U.S. governments, central banks or supranational entities such as the International Monetary Fund, or by the imposition of currency controls or other political developments in the U.S. or abroad. As a result, the Private Funds' investments in non-U.S. currency-denominated assets are subject to the risk that those currencies will decline in value relative



to the U.S. dollar. To the extent this risk is not adequately hedged (as discussed above), the returns on these investments could be adversely affected.

**Valuation.** The Private Funds' portfolios contain numerous illiquid, subordinate, non-traded, or lightly traded investments held in a variety of countries for which a traditional fair market value would be difficult and expensive, if not impossible, to determine. Therefore, private equity funds, like the Private Funds, customarily use discounted cash-flow value as a surrogate for traditional fair market value calculations. Fair value estimates involve calculations of expected future cash flows, the timing of receipt of those expected cash flows, and the discount rate applied to the overall cash flows. The fair value of a Private Fund asset includes unrealized gains and losses, and may be adjusted by any cash distributed or contributed to the Private Funds or to reflect any permanent impairments to the asset values as determined by the Hudson Entities. Therefore, the fair value of assets may vary from actual amounts realized upon the disposition of those assets. There can be no assurances that the fair value determinations, or the assumptions used to make those determinations, will prove to be accurate. The Private Funds may rely on valuations they receive from third parties in determining the price paid for assets. Such valuations may turn out to be inaccurate and therefore affect the Private Funds' returns with respect to such assets. There can be no certainty that the price paid for an asset by a Private Fund will be equal to or less than the determined fair value, and as such, this may have an impact on the fair value as it is calculated on a discounted cash-flow, rather than a price-paid, basis.

**Taxation.** Investments in operating companies, real estate, and real estate-related assets may be subject to numerous taxes, fees, and duties by the jurisdiction in which such assets reside or operate. Each investor in a Private Fund will be taxed on the income of the Private Fund regardless of whether the investor receives any actual cash distributions, and an investor's tax liability associated with an investment in the Private Fund for a certain taxable year may exceed the cash distributions during the taxable year. A significant portion of a Private Fund's investments may be made outside of the U.S. and foreign taxes incurred with respect to those investments could be substantial. The investments of the Private Funds are structured to minimize taxes to the extent permitted by law. If such a structure fails to operate as intended, however, it could expose the Private Funds to unexpected taxation that may reduce the returns of the Private Funds. Under certain circumstances, these tax liabilities could be incurred by the limited partners of the Private Funds directly.

**Risks of Environmental Liabilities.** Under various laws, ordinances, and regulations, an owner or operator of real property may become liable for the costs of removal or remediation of certain hazardous substances and other environmental pollutants (including, without limitation, petroleum products, asbestos, and polychlorinated biphenyls) released on, about, under, or in its property. Environmental laws often impose this liability without regard to whether the owner or operator knew of, or was responsible for, the release of hazardous substances or other environmental pollutants. The presence of hazardous substances or other environmental pollutants, or the failure to remediate hazardous substances or other environmental pollutants properly, may adversely affect the owner's ability to sell or use real estate or to borrow outside funds using real estate as collateral.

**Regulatory Risks.** There is no assurance that the investments of the Private Funds will be able to: (i) obtain all required regulatory approvals not yet acquired, or that may need to be acquired in the future; (ii) obtain any necessary modifications to existing regulatory approvals; or (iii) maintain required regulatory approvals. Delay in obtaining or failure to obtain and maintain in full force and effect any regulatory approvals, or amendments thereto, or delay or failure to satisfy any regulatory conditions or other applicable requirements could prevent operations of a portfolio company, impede the development of real estate assets, delay the completion of a previously announced acquisition or sale to third parties, or otherwise result in additional costs to a portfolio company, or other investment, and in turn the Private Funds. The global investment strategy of the Private Funds is subject to complex, changing, and

sometimes competing legal, tax, and regulatory regimes throughout the world, and there is a possibility that new or changing regulatory requirements could potentially have adverse effects on the Private Funds. Derivative contracts, repurchase agreements, and similar instruments used to implement hedging and financing activities of the Private Funds are generally subject to limited regulation. New regulation in the U.S. or in non-U.S. jurisdictions relating to such instruments may limit the ability of the Private Funds to engage in the same or similar transactions in the future, and there is a possibility that regulatory agencies may treat these instruments differently than the manner intended by the Private Funds. Such developments may prevent or delay the implementation of hedging or financing transactions, or result in the termination of existing arrangements. The Private Funds may not be able to re-establish similar arrangements in a timely manner, or on the same terms as the prior financing arrangement, or on any terms.

## **Item 9: Disciplinary Information**

In October 2003, Lone Star Fund IV (U.S.), L.P. and Lone Star Fund IV (Bermuda), L.P. (“Investing Funds”), together with certain co-investors, purchased, through various non-U.S. entities, a controlling interest in Korea Exchange Bank (“KEB”), a South Korean commercial bank. The Investing Funds held their interest in KEB through a special purpose vehicle, LSF-KEB Holdings, SCA (“KEB Holdings”), whose statutory manager was LSF KEB Management SPRL. The permanent representative of LSF KEB Management SPRL was Michael Thomson, Executive Vice President and General Counsel of LSUS and Chairman and Director of LSGA. After KEB Holdings assumed control of KEB, several persons affiliated with KEB Holdings were elected to the Board of Directors of KEB, including Paul Yoo, Ellis Short, Michael Thomson, and Steven Lee (“Lone Star Directors”).

In November 2003, the Board of Directors of KEB considered the acquisition of KEB’s credit card affiliate (“KEB Credit”), in order to avert its impending insolvency. The KEB Board of Directors, recognizing that a merger of KEB and KEB Credit was the only viable solution for the massive fiscal problems faced by KEB Credit, resolved to pursue a merger, provided that the details of the merger plan, including a possible capital reduction of KEB Credit to reflect the precise value of KEB Credit, would be approved by the KEB Board of Directors in the future. If the capital reduction were to occur, it could impair the rights of shareholders of KEB Credit in a merger with KEB. KEB publicly disclosed this resolution to the Korea Stock Exchange (“KSE”) as required by the KSE rules, and also made a press release to the same effect. The Board of Directors of KEB ultimately resolved, however, to merge with KEB Credit without such a capital reduction.

In 2006, the Korean Supreme Prosecutor’s Office charged KEB, KEB Holdings, and Paul Yoo, who was also a senior officer of LSGA’s Korean subsidiary, Lone Star Advisors Korea, L.L.C., with violations of the Korean Securities and Exchange Act (“SEA”) in connection with KEB’s merger with KEB Credit. The charges alleged in part that the Lone Star Directors conspired to release the press release and discuss the capital reduction of KEB Credit, when they had no actual intent to consider and proceed with a capital reduction of KEB Credit. In addition, the charges alleged that Lone Star Directors released the press release with the knowledge that it might decrease the stock price of KEB Credit, for the purpose of enabling KEB to merge with KEB Credit on more favorable terms. In October 2011, after several decisions and appeals, KEB Holdings and Paul Yoo were found by the Seoul High Court to have violated the SEA. Paul Yoo was sentenced to three years imprisonment. The Seoul High Court also imposed a criminal fine of KRW 25 billion (approximately USD 22.4 million) on KEB Holdings.

Under the SEA as applied in line with the Korean Constitutional Court’s prior rulings, a court must find that a company’s legal “representative” was involved in alleged violations in order to convict the company. The Seoul High Court’s decision against KEB Holdings was based on the activities of Michael Thomson, whom the Court considered to be the legal “representative” of KEB Holdings for purposes of

the SEA. No charges were brought against Ellis Short, Michael Thomson, or Steven Lee, the other Lone Star Directors. No Lone Star Director other than Paul Yoo participated in the proceedings. The Registered Advisers have been advised by Korean counsel that the court's finding against KEB Holdings is not a conviction against these individuals personally.

In December 2011, the Korean Financial Services Commission ("FSC") issued a Resolution Notice to KEB that required KEB to consider the dismissal of the Lone Star Directors at a shareholders meeting within two months of the Resolution Notice. The FSC based this action on the findings of the Seoul High Court. In February 2012, KEB Holdings sold its remaining interests in KEB, and the Lone Star Directors resigned prior to any action being taken by KEB with respect to the Lone Star Directors.

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

Neither the Registered Advisers nor their management persons are registered as broker-dealers, nor do they have any applications pending to register with the SEC as a broker-dealer or registered representative of a broker-dealer. The Registered Advisers and their management persons are not registered as, and do not have any application pending to register as, a futures commission merchant, commodity pool operator, commodity trading advisor, or an associated person of the foregoing entities.

LSGA is the parent entity of a number of subsidiaries, including LSUS and the Participating Affiliates. With respect to LSGA's advisory services, each Participating Affiliate is registered, or believes it is exempt from registration, under the laws of the jurisdiction in which it is located. The Participating Affiliates are (1) Lone Star Japan Acquisitions Ltd. (Japan *kabushiki kaisha*); (2) Lone Star Management Europe, Ltd. (Bermuda exempted company); (3) Lone Star Management Europe Limited (United Kingdom company limited by shares); and (4) Lone Star Germany GmbH (German company with limited liability).

As noted above in Item 4, LSGA has material business relationships with the General Partners of each Private Fund, LSUS, and the Participating Affiliates. The General Partners have, on behalf of each Private Fund, granted to LSGA the authority to provide advisory and other services to the Private Funds. LSGA sub-contracts, on a regional basis, certain obligations owed to the Private Funds. Specifically, LSGA has entered into agreements with LSUS to provide origination services in North America, and with each Participating Affiliate to provide origination services within its respective region. The applicable Lone Star Entity providing the services is determined based on the geographical location of the Private Fund's potential investment.

In reliance on a series of SEC no-action letters, LSGA has entered into arrangements with each of its Participating Affiliates whereby LSGA utilizes the investment management capabilities and related services, including certain personnel, of these Participating Affiliates in providing advice to LSGA's clients. The Participating Affiliates are not registered with the SEC as investment advisers. However, employees of the Participating Affiliates that assist in providing investment advice to LSGA are subject to the regulatory oversight of both LSGA and the SEC, and are subject to the Registered Advisers' Code of Ethics and other compliance policies and procedures adopted by the Registered Advisers pursuant to the requirements of the Investment Advisers Act of 1940, as amended ("Advisers Act").

The Lone Star Entities are under common control with HAL, HAM and HAL's participating affiliates, which are: (1) Hudson Advisors Luxembourg S.A.R.L.; (2) Hudson Advisors Ireland Limited; (3) Hudson Advisors Germany GmbH; (4) Hudson Advisors UK Limited; (5) Hudson Japan K.K.; and (6) Hudson Advisors Servicing Co. Ltd. As discussed above, these Hudson Entities perform due diligence and

analysis services, asset management services, ancillary services and hedging services with respect to certain investments made by the Private Funds. HAL and HAM are both SEC-registered investment advisers.

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

### **Code of Ethics Adopted Pursuant to SEC Rule 204A-1**

The Registered Advisers have adopted the following three codes, which set forth certain standards for the Registered Advisers' employees, certain employees of LSGA's Participating Affiliates, and certain other persons subject to the Code ("Covered Persons"): (1) a Code of Ethics; (2) a Supplemental Code of Ethics; and (3) an Insider Trading Policy and Procedures (collectively, the "Code"). The Registered Advisers adopted the Code in accordance with Advisers Act Section 204A. The Code has been adopted in recognition of the Registered Advisers' fiduciary duty to place the interests of the Private Funds before the interests of the Registered Advisers and their employees, which must be upheld, in part, by addressing both actual and perceived conflicts of interest. The Code is intended to promote ethical conduct, provide guidelines and reporting requirements to help ensure compliance by the Registered Advisers and Covered Persons with applicable federal and state securities laws and regulations, and reinforce the fiduciary principles that govern the conduct of the Registered Advisers and Covered Persons.

While the Registered Advisers' clients and Covered Persons may invest, or have already invested, in obligations and/or other securities that are identical to or senior to, or have interests different from or adverse to, eligible client investments, the Code includes certain provisions regarding transactions in certain securities ("Reportable Securities") and other investments by Covered Persons. The Code, among other things, restricts the purchase and sale by Covered Persons for their own account of Reportable Securities that are purchased by clients. It requires Covered Persons to pre-clear the purchase or sale of Reportable Securities, including transactions in initial public offerings and limited offerings or private placement securities. Requests for trading authorization will be denied when, among other reasons, the proposed personal transaction would be contrary to the provisions of the Code. Covered Persons are required to provide initial and annual reports of holdings of Reportable Securities and quarterly reports of transactions involving Reportable Securities. Transactions in Reportable Securities are reviewed for compliance with the Code. In addition, the Code requires disclosure by the Registered Advisers' personnel of potential conflicts of interest with respect to the Registered Advisers' clients, and establishes policies regarding other matters, such as the giving or receiving of gifts and entertainment.

The Registered Advisers may, from time to time, come into possession of material, nonpublic and other confidential information which, if disclosed, might affect an investor's decision to buy, sell or hold a security. Under applicable law, the Registered Advisers and Covered Persons are prohibited from improperly disclosing or using this information for their personal benefit or for the benefit of any other person, regardless of whether such other person is an advisory client. Accordingly, should the Registered Advisers and/or Covered Persons come into possession of material, nonpublic or other confidential information with respect to any company, issuer or security, they may be prohibited from communicating such information to, or using such information for the benefit of, their respective clients. The Registered Advisers and Covered Persons have no obligation to disclose the information to or use such information for the benefit of clients. The Registered Advisers and Covered Persons also do not have any responsibility or liability for failing to disclose such information to clients as a result of following the Registered Advisers' policies and procedures designed to ensure that the Registered Advisers and Covered Persons comply with their obligations with respect to such information.

Further, by reason of their responsibilities to the Private Funds, and notwithstanding procedural safeguards including restricted securities and watch lists, the Lone Star Entities and the Hudson Entities may come into possession of confidential or material nonpublic information that would limit their ability to direct the purchase or sale of certain investments. The Lone Star Entities and the Hudson Entities may, therefore, be restricted from initiating transactions in certain securities on a client's behalf, due to the acquisition of confidential or material nonpublic information, at a time when action would otherwise be taken.

The Code establishes procedures to prevent the misuse of material information by all of the Registered Advisers' employees, officers, directors and other Covered Persons. Any member, officer, director, or employee of the Registered Advisers or other Covered Person who fails to observe the above-described policies risks serious sanctions, including dismissal and personal liability.

The Registered Advisers will provide a copy of the Code to any client, prospective client, or Private Fund investor or prospective investor upon written request to the Chief Compliance Officer, Lone Star U.S. Acquisitions, LLC/Lone Star Global Acquisitions, Ltd., 2711 N. Haskell Avenue, Suite 1700, Dallas, Texas 75204.

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

#### ***Participation or Interest in General***

Except for investments in the Co-Investment Vehicles, interests held directly by General Partners in the Private Funds, and limited partnership and other ownership interests in the General Partners held by certain Covered Persons, none of the Registered Advisers, their related persons, or their employees invest in opportunities recommended to the Private Funds. Additionally, the Registered Advisers, their affiliates and their employees may be restricted from investing in certain securities for themselves or their clients due to the receipt of confidential or material, nonpublic information. In accordance with anti-fraud provisions of the Advisers Act and the Registered Advisers' internal compliance policies and procedures, the Registered Advisers and their affiliates will not, as principal, transact in securities with the Private Funds without first disclosing in writing the Registered Advisers' capacity in the transaction and obtaining the consent of the Advisory Committee(s) of the relevant Private Fund(s), which are defined and discussed below. HAL may engage in non-securities hedging transactions to help mitigate foreign currency risk on its compensation earned in currencies other than the U.S. dollar. HAL may conduct these hedging transactions, in what are traditionally liquid currency markets, in HAL's own accounts. As a result of this hedging activity, HAL may hold the same or different positions than the Private Funds in a given currency.

#### ***Co-Investment Opportunities***

Certain key employees of the Lone Star Entities and the Hudson Entities are given the opportunity, through a Co-Investment Vehicle, to co-invest with each Private Fund, on a side-by-side basis and on the same economic terms (on a *pro rata* basis, taking into account the size of the investment), in each investment that the Private Funds acquire. When key employees agree to participate in the Co-Investment Vehicle, they consent to the terms of co-investment transactions in which the Co-Investment Vehicle will participate. Distributions to key employees who participate in a Co-Investment Vehicle are net of certain asset management fees paid to the Hudson Entities. The Co-Investment Vehicles do not pay any fees to the Registered Advisers. The Co-Investment Vehicles are disclosed in the Offering Documents of the Private Funds.

Certain Private Funds, each of which has terminated its commitment period, made financing available to key employees participating in co-investment opportunities through a promissory note that bears interest

at a commercial rate and on a full recourse basis with the key employee's interest in the co-investment as collateral. The amounts borrowed are generally repaid from any and all distributions from the co-investment. The General Partner of a Private Fund may, under certain circumstances such as the death or incapacity of a key employee, and in its sole discretion, purchase such a loan from the Private Fund for an amount equal to the outstanding principal and accrued interest of the loan. In such cases, the General Partner will enter into arrangements to ensure that any profit associated with such a purchase is repaid to the Private Fund. With respect to Private Funds that are currently in their investment period, HAL and/or one of its subsidiaries may provide financing, directly or indirectly, to key employees that participate in a Co-Investment Vehicle. The financing provided to key employees may be extensive, may have a significant effect on the net worth of these employees, and may influence employees responsible for the provision of investment advice to recommend higher risk investments than they otherwise would.

The Co-Investment Vehicles are designed to align the interests of the Lone Star Entities' and the Hudson Entities' key employees with those of the Registered Advisers' clients, the Private Funds. The key employees who participate in the Co-Investment Vehicles have personal assets at risk alongside the investors in the applicable Private Fund. These arrangements do, however, also present conflicts of interest. For example, because participants in the Co-Investment Vehicles typically decide whether to invest at a later time than the investors in the Private Funds, the participants in the Co-Investment Vehicle may, at the time of their investments, have information regarding potential investments that may be more comprehensive than information known by the Private Funds' underlying investors at the time they made their investments. However, once a key employee decides to participate in a Co-Investment Vehicle with the Private Funds currently in their investment periods, that key employee has no ability to opt out of the Co-Investment Vehicle's future investments. The General Partner of the participating Private Fund and HAL will decide on the amount of the Co-Investment Vehicle's participation in each investment, within a range of 0.2% to 1%. Accordingly, the maximum contribution a Co-Investment Vehicle can make to an investment is immaterial in relation to the total investment made by the participating Private Fund. The personnel of the Lone Star Entities, the Hudson Entities, and their affiliates who participate in a Co-Investment Vehicle may have an incentive to recommend the acquisition or disposition of assets based on their personal interests rather than the best interests of the applicable Private Fund. In addition, employees who participate in the Co-Investment Vehicles may not be financially able to meet capital calls. The Registered Advisers have implemented policies and procedures, including the Code, that are designed to help mitigate these conflicts and ensure that the Registered Advisers' personnel act in the best interests of the Registered Advisers' clients at all times.

Consistent with the limited partnership agreement of each Private Fund, the Private Fund may temporarily fund the entire cost of the initial acquisition of an investment, subject to the Co-Investment Vehicle's obligation to reimburse the Private Fund after calling capital for the investment. Amounts temporarily funded by the Private Fund accrue interest that is paid to the Private Fund together with the reimbursement of capital. With respect to an initial investment, the Co-Investment Vehicle shares in the risks and benefits of hedging and financing transactions that occur prior to reimbursement of the Private Fund, although the Private Fund is directly exposed to the Co-Investment Vehicle's share of these risks, as well as investment-related risks, prior to reimbursement. The employees who participate in a Co-Investment Vehicle are required to fund their weighted average share of any unconsummated transaction costs.

When executing certain hedging transactions, HAL aggregates orders for the applicable U.S./Bermuda Private Funds and any Co-Investment Vehicle invested in an asset. When aggregating orders, the Hudson Entities determine the total amount to be hedged for such investment, execute the hedging transaction for the applicable U.S./Bermuda Private Funds on a collective basis, and then allocate the trade among the U.S./Bermuda Private Funds and any Co-Investment Vehicle invested in the asset, based in proportion to their respective capital commitments.

## **Investment Opportunity Allocations and Cross Transactions**

When a Private Fund invests, its U.S./Bermuda Private Funds invest on a side-by-side basis in proportion to the respective capital commitments of each fund pursuant to a side-by-side investment agreement. Likewise, the U.S./Bermuda Private Funds enter into a co-investment agreement with HAL whereby the Co-Investment Vehicles invest on a side-by-side basis with the U.S./Bermuda Private Funds. Pursuant to these agreements, certain expenses of an investment transaction may be paid by one of the U.S./Bermuda Private Funds, and subject to reimbursement by the other U.S./Bermuda Private Fund and any associated Co-Investment Vehicle. In such circumstances, the U.S./Bermuda Private Fund that has paid these expenses bears the risk that the other U.S./Bermuda Private Fund or the Co-Investment Vehicle will not have sufficient capital to reimburse the expenses in a timely fashion, or at all. The limited partnership agreements of the Private Funds currently in their investment periods provide contractual safeguards regarding how a potential investment is chosen for a particular Private Fund. Specifically, each of the limited partnership agreements describes the types of investments that each of the Private Funds can make without overlap between them. In situations where a potential investment portfolio contains assets that may be suitable for more than one Private Fund, each Private Fund's respective limited partnership agreement clarifies that the portfolio may be purchased by the Private Fund whose permitted investments are most closely aligned with the predominant asset class of the potential investment portfolio (even though the portfolio may contain some assets that could be purchased by the other Private Fund).

In limited circumstances, a Private Fund may sell or transfer to, or participate in, the assets of the investment portfolio of another Private Fund. For example, in limited situations a Hudson Entity may concurrently assist two clients in sales of similar investments (such as the same tranche of CDO bonds), and a Lone Star Entity may provide advice with respect to such a transaction. To address potential conflicts, the Registered Advisers have implemented procedures to require that all clients be treated fairly and equally. Furthermore, the limited partnership agreement of each applicable Private Fund requires prior approval of all conflicts of interest between a Lone Star Entity and a Private Fund or among Private Funds, including proposed cross or principal transactions, by the Advisory Committee(s) of the applicable Private Fund(s). The Advisory Committee of each Private Fund is created pursuant to its limited partnership agreement and is comprised of representatives of the Private Fund's investors (the "Advisory Committee"). Neither the Registered Advisers nor any of their supervised persons serve on the Advisory Committee of any of the Private Funds.

The Advisory Committee meets with the Private Fund's General Partner throughout the year to consider and advise on conflicts of interest, the Private Fund's investment strategy and other matters relating to the business of the Private Fund. When a conflict of interest is presented, including a prospective cross or principal transaction, information on the transaction is presented to the Advisory Committee(s) of the Private Fund(s) involved to determine if the transaction is in the best interest of the Private Fund(s), and the Advisory Committee approves or rejects the transaction. If there is a purchase by one Private Fund of another Private Fund's assets, it is contemplated that a Lone Star Entity, a Hudson Entity and/or a third party would determine the fair market value of the assets involved, subject to the review and approval of the Advisory Committee of each Private Fund.

## **Item 12: Brokerage Practices**

### **Counterparty Selection**

The Lone Star Entities seek to obtain best price and execution for all transactions made on behalf of the Private Funds, to trade assets in a manner that is fair to all clients, and to exercise diligence and care throughout the transaction process. The types of assets in which the Private Funds invest may only be

available from one or a small number of counterparties. In connection with origination services related to the purchase of securities, the Lone Star Entities typically recommend transactions in distressed RMBS, CMBS, CDOs and asset-backed securities for which there is not a liquid market and for which many of the securities are closely held by a small number of broker-dealers or other financial institutions. In connection with origination services related to the purchase of loans, real estate, operating companies, and other assets, the Lone Star Entities typically negotiate directly with the seller of the asset, or through a broker that has been exclusively retained by the seller for the disposition of the asset. Because the Private Funds typically invest in assets that may be purchased from only one or a small number of counterparties, the Lone Star Entities may not be able to negotiate terms that are as favorable as those that may be available in a market with more potential counterparties.

With respect to transactions in both securities and non-securities, the Lone Star Entities' origination activities typically involve the negotiation of private deals in illiquid or lightly traded assets for which a broker-dealer, if involved at all, does not act in its traditional intermediary capacity. Instead, the Lone Star Entities consider the price of an asset and the execution capabilities of a counterparty, which may be a broker-dealer, as an integral part of its origination services. In identifying a counterparty for negotiated transactions in illiquid assets, the Lone Star Entities may also consider the counterparty's willingness and ability to provide the clients with financing on the assets being purchased, including the willingness of a counterparty to finance the clients' purchase of the assets through a repurchase facility.

On occasion, the Lone Star Entities will recommend the purchase of securities for which there is a more liquid market or provide strategic or other related advice with respect to the sale of such securities. In such circumstances, the Hudson Entities, which are responsible for the execution of trades, will seek to execute the transaction with the broker-dealer that provides best price and execution of such transaction under the circumstances.

In seeking best execution, the Lone Star Entities and the Hudson Entities consider a variety of factors, including:

- (i) the ability of a counterparty to present the applicable Private Fund with a transaction that meets its investment goals;
- (ii) the credit availability of the applicable Private Fund with the counterparty;
- (iii) the financing terms (if any) that the counterparty is willing to provide to the Private Funds in connection with the acquisition of the investment;
- (iv) the reliability, integrity, financial condition and execution capability of the counterparty being considered for effecting transactions in light of the size and complexity of the transaction;
- (v) the price or spread;
- (vi) the commission rates, if any;
- (vii) the ability of the broker-dealer to maintain confidentiality of a transaction;
- (viii) the speed of execution; and
- (ix) settlement reliability and accuracy of the broker-dealer.

Although the Lone Star Entities and the Hudson Entities generally seek to pay the best price under the circumstances, they will not necessarily always do so. Transactions may involve specialized services or considerations (such as the type of assets the Private Fund is seeking to purchase or the availability of financing opportunities to the applicable Private Fund) that must be considered when selecting a counterparty and thereby entail higher markups or commissions than would be the case with transactions that do not involve any specialized services or considerations.



### **Research, Other Soft Dollar Arrangements and Client Referrals**

The Lone Star Entities receive proprietary research and other services from certain broker-dealers, which they may use to equally service all of the Private Funds. The Lone Star Entities do not, however, cause the Private Funds to pay increased commissions in order to obtain the research and services provided by broker-dealers, and the Lone Star Entities do not consider the provision of such research and services in the recommendation or selection of broker-dealers. When identifying potential transactions and selecting broker-dealers for those transactions, neither the Lone Star Entities nor the Hudson Entities consider whether a potential broker-dealer provides referrals of investors to the Private Funds. A Lone Star Entity may, however, as discussed above, select a broker-dealer based on its ability to source investments for the Private Funds. The Lone Star Entities do not enter into commission sharing agreements with broker-dealers relating to transactions executed for the benefit of the Private Funds, or participate in directed brokerage arrangements. Further, the Lone Star Entities will not accept directed brokerage instructions from the Private Funds or their underlying investors.

### **Other Third Parties**

In addition to transactions with banks and broker-dealers, the Lone Star Entities may engage other service providers on behalf of the Private Funds with respect to the execution of transactions, such as lenders and real estate brokers and agents. These service providers are subject to similar selection criteria as broker-dealers, but may also be selected based on the geographic location of the assets and the service provider's experience with the type of assets involved.

### **Aggregation of Client Transactions**

The Lone Star Entities generally do not aggregate orders for the Private Funds, although the Lone Star Entities and the Hudson Entities do aggregate the transactions of a Private Fund among its U.S./Bermuda Private Funds and Co-Investment Vehicle(s) as described in Item 11.

### **Item 13: Review of Accounts**

Ongoing management of each investment is typically performed by the Hudson Entity that operates in the geographic region where the investment is located. The Hudson Entity manages the investment according to the Business Plan, if any, then in effect for the investment. As part of its advisory services to the Private Funds, the applicable Hudson Entity typically engages in a formal review of the investments in the account of each Private Fund on a quarterly basis. The Hudson Entity analyzes whether the investment is performing as anticipated, highlights any positive or negative information related to the investment and takes any necessary action based on its analysis. In addition to formal quarterly reviews, the Hudson Entities periodically review investments of the Private Funds on a more frequent basis to consider financing opportunities and sales opportunities, or to develop additional asset management strategies for the investments. Quarterly and periodic reviews are supervised by the head of asset management for the asset class being reviewed in the relevant region.

The Hudson Entities discuss the quarterly reviews with the applicable Region Head, and provide the Region Head with quarterly reports and other information regarding performance of the investment. The Region Head analyzes whether the investment is performing as anticipated, and provides strategic and related advice based on that analysis. In addition to formal quarterly reviews, the Hudson Entities frequently discuss periodic investment reviews with the applicable Region Head, who provides strategic and related advice with respect to the specific investment under review.

On a quarterly basis, HAL prepares for the General Partner of each Private Fund an unaudited balance sheet, statement of operations, portfolio cash summary and status reports of the Private Fund's investments and activities during the applicable period, including summary descriptions of material new acquisitions and material dispositions. The General Partner distributes such reports to the limited partners in each Private Fund on a quarterly basis within 60 days after the end of each quarter. In addition, the limited partners receive audited financial statements within 120 days of the Private Fund's fiscal year end.

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

The Registered Advisers do not receive economic benefits from a non-client for providing investment advice or other advisory services to their clients. Also, neither the Registered Advisers nor their related persons directly or indirectly compensate any third party for client referrals. A General Partner may pay for third-party referrals of investors into the Private Funds.

#### **Item 15: Custody**

The Lone Star Entities generally have custody (as defined in the Advisers Act) of the assets of the Private Funds. The Private Funds and their underlying investors receive annual audited financial statements from the Private Funds' auditor.

#### **Item 16: Investment Discretion**

The Registered Advisers provide origination and investment management services involving a significant amount of investment discretion to the Private Funds. Although each General Partner may impose restrictions on the Registered Advisers' discretion, it is not anticipated that a General Partner would do so. The Registered Advisers' discretion is implemented pursuant to the terms of agreements to which LSGA and the General Partners are parties, and pursuant to the terms of LSGA's agreement with LSUS.

#### **Item 17: Voting Client Securities**

The Registered Advisers do not engage in proxy voting on behalf of their clients.

#### **Item 18: Financial Information**

The Registered Advisers do not require or solicit prepayment of fees. The Registered Advisers have never filed for bankruptcy and are not aware of any financial condition that is expected to affect or is reasonably likely to impair their ability to meet their contractual obligations to their clients.