

Tolis Advisors, LP Form ADV Part 2A



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This Form ADV Part 2A (the “Brochure”) provides information about the qualifications and business practices of Tolis Advisors, LP (“Tolis”). If you have any questions about the contents of this Brochure, please contact Salvatore Puliafico, Chief Operations Officer, Chief Financial Officer, & Chief Compliance Officer, via telephone at +1 646.863.6120 and/or e-mail at spuliafico@tolisadvisors.com. The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission (the “SEC”) or by any state securities authority.

Additional information about Tolis is also available on the SEC’s website at: www.adviserinfo.sec.gov. The SEC’s website also provides information about any persons affiliated with Tolis who are registered or required to be registered, as investment adviser representatives of Tolis. Registration of an investment adviser with the SEC does not imply any level of skill or training.

Item 2: Material Changes

This is Tolis Advisors, LP's initial firm Brochure, so there are not any material changes at this time. In the future, this Item will be used to summarize material new and/or updated information since the last annual (or initial) update of the Brochure.

Clients and prospective clients should review this entire Brochure carefully.

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Item 4: Advisory Business

Founded by Eric Banks in 2007, Tolis Advisors, LP, is a Delaware limited partnership. Tolis is a New York based multi-sector, multi-strategy structured credit asset manager. The firm is managed and wholly owned by its four principals: Eric Banks, Spencer Parker, Salvatore Puliafico, and Jerome Thomas.

Tolis currently provides investment management services to three funds in a single master-feeder structure. The master-feeder structure includes Tolis Investment Strategies Master Fund Ltd (the “Master Fund”) as the “master fund”, and a domestic “feeder fund” and an offshore “feeder fund” (together with the Master Fund, the “Funds”). The feeder funds typically place all of their investable assets in the Master Fund, and investment activities and investment discretion are generally conducted at the Master Fund level where Tolis acts as investment manager to the Master Fund.

Tolis also may serve as the investment adviser or sub-adviser with discretionary or non-discretionary trading authority for separately managed accounts and private funds sponsored or managed by an unaffiliated manager (“Separate Accounts”).

Tolis applies a consistent fundamental value based, multi-strategy, multi-sector approach to structured credit assets, which generally include: collateralized debt obligations (“CDOs”), residential mortgage-backed securities (“RMBS”), commercial mortgage backed securities (“CMBS”), and asset backed securities (“ABS”) (together, “Structured Credit Securities”).

The focus of Tolis’ investment strategy is to uncover and exploit market and structural inefficiencies in order to invest in assets exhibiting risk profiles which couple material upside with capital preservation. The ultimate goal is to deliver equity like upside returns with a senior secured risk profile. Tolis also utilizes other strategies that are complementary to its structured credit strategies.

Separate Accounts are subject to investment objectives, guidelines, restrictions, fee arrangements and other terms that are individually negotiated. Separate Account relationships generally involve significant account minimums. Tolis tailors its advisory services to the specific investment objectives and restrictions of each client. Tolis may enter into side agreements with specific investors in the Funds providing for different fees, redemption rights, capacity rights, access to information about the Funds or Tolis, or other matters relating to an investment in the Funds.

Tolis is generally granted broad investment authority with respect to the management of the Funds, although certain restrictions may be imposed with respect to Separate Accounts. Tolis may pursue different investment strategies for different clients. For more information on Tolis’ investment strategy, please see Item 8: Methods of Analysis, Investment Strategies and Risk of Loss.

Tolis does not participate in wrap fee programs.

As of September 1, 2014, Tolis had approximately USD \$112.32 million of regulatory assets under management. Approximately USD \$107.14 million is managed on a discretionary basis and approximately USD \$5.18 million on a non-discretionary basis.

Item 5: Fees and Compensation

Typically, each client pays Tolis fixed asset-based management fees and performance-based compensation.

The basic fees charged to investors in the Funds are fixed annual “Asset-based Charges” equal to a percentage of net assets, accruing monthly in arrears and generally payable at the end of each calendar quarter, and an annual performance allocation typically equal to a percentage of the amount by which the net value of each investor’s investment as of the end of each calendar year exceeds the net value of the account as of the beginning of the year. Tolis may agree to reduce, modify or waive its fees charged to certain accounts in its sole discretion.

The Asset-based Charges are usually deducted directly from the assets of each Fund as such fees become payable, which is generally quarterly. The performance allocation is payable annually in arrears, or upon termination of the advisory relationship with the Funds or withdrawal of capital from the Funds. Upon termination of Tolis’ advisory relationship with the Funds, all management fees accrued as of the date of termination will be payable.

Investors and prospective investors in each Fund should refer to the confidential private placement memorandum, limited partnership agreement and other governing documents for each Fund for complete information on the fees charged by Tolis.

Fees for Separate Accounts managed by Tolis are calculated and billed in accordance with the terms of any applicable account management agreement as negotiated between the parties.

While Tolis believes that its compensation is competitive with compensation charged by other investment advisers for comparable services, clients and investors in the Funds should note that similar advisory services may (or may not) be available from other investment advisers for similar or lower fees.

The Funds will bear all expenses associated with the investment activities and operations of the Funds (including each feeder fund bearing its proportionate share of the expenses of the Master Fund), including, without limitation, brokerage commissions, interest on margin accounts and other indebtedness, borrowing charges on securities sold short, custodial fees, bank service fees, costs of any outside appraisers, accountants, attorneys or other experts or consultants engaged by Tolis, expenses in connection with proposed transactions (including transactions that fail to close), research and data service costs, any legal fees and costs (including settlement costs) arising in connection with any litigation or regulatory investigation instituted against the Funds or Tolis in connection with the affairs of the Funds, legal, accounting, auditing and tax services and fees, withholding and transfer taxes, clearing and settlement charges, fees of the Funds’ administrator, fees of the Fund’s directors (if applicable), insurance costs, costs of preparing required regulatory filings, costs of communication with or holding meetings with investors in the Funds, and any other expenses related to the purchase, sale or holding of investments.

With respect to each feeder fund, if Reimbursable Expenses (as defined below) in any fiscal year exceed 1.0% of the average month end Net Asset Value of such feeder fund during such fiscal year, then the amount of the Asset-based Charges payable to Tolis will be reduced by the amount of the excess (the “Expense Reimbursement”). In the event that the Expense Reimbursement in any fiscal year exceeds the

amount of the Asset-based Charges payable with respect to such fiscal year for any feeder fund, then Tolis will pay such feeder fund the amount of such excess. For this purpose, “Reimbursable Expenses” means, with respect to any fiscal year, all ordinary operating expenses of a feeder fund, including the amortized portion of organizational expenses attributable to such fiscal year and such feeder fund’s allocable share of the ordinary operating expenses of the Master Fund, but excluding Asset-based Charges, the Performance Allocation (described in Item 6: Performance-Based Compensation and Side- By-Side Management), all investment and trading expenses (including without limitation brokerage commissions, interest and taxes), and any extraordinary expenses. If the Reimbursable Expenses in any subsequent fiscal year are less than 1.0% of the feeder fund’s Net Asset Value, subject to such limit in such subsequent fiscal year, the Asset-based Charges to be paid to Tolis will be increased by an amount not to exceed the aggregate amount of the Expense Reimbursements previously paid by Tolis (whether directly or through an offset to the Asset-based Charges) in the three fiscal years immediately preceding such subsequent fiscal year, to the extent such Expense Reimbursements have not previously been reimbursed to Tolis.

All costs and expenses associated with the organization of each Fund were paid by the Funds and are being amortized over 60 months.

Item 12, “Brokerage Practices” describes the factors Tolis considers in selecting or recommending broker-dealers and determining the reasonableness of their compensation.

Item 6: Performance-Based Compensation and Side-By-Side Management

Tolis or an affiliate of Tolis ordinarily receives a performance-based fee or a special allocation of profits from each of its clients (including the Funds) as described in Item 5, “Fees and Compensation.” Different client accounts may be subject to different performance-based compensation arrangements. Please refer to the applicable governing documents or account management agreement for more complete information on the performance-based compensation arrangements of each Fund or Separate Account.

The performance-based compensation arrangements discussed above comply with Rule 205-3 under the Investment Advisers Act of 1940 (the “Advisers Act”).

Performance-based compensation arrangements received by Tolis or its related persons may create an incentive for Tolis to recommend investments that may be riskier or more speculative than those that would be recommended under a different fee arrangement. If Tolis is entitled to receive a higher percentage of the net profits of the account of one client than the percentage that Tolis receives from another client, then Tolis may have an incentive to favor, or to allocate certain riskier or more speculative investments to, the client that is subject to the higher percentage.

Tolis will, as a policy, allocate all investment opportunities among its clients in a manner that it considers fair and equitable to all clients, considering all factors potentially applicable to each client. Among the factors that may be considered by Tolis in allocating trades among client accounts are: investment policies, guidelines or restrictions applicable to each specific client; tax considerations; cash availability; liquidity requirements for payment of redemptions or other purposes; risk tolerances; restrictions under the Employee Retirement Income Security Act of 1974, as amended, or other applicable laws or regulations; available credit lines; counterparty arrangements; account size; benchmark sector weightings; industry and security weightings; and hedging objectives and activity.

Item 7: Types of Clients

Tolis provides investment advice to its clients, including Separate Accounts and the Funds. The Separate Account clients and investors in the Funds may include pension funds, endowments, foundations, funds of funds, high net worth individuals, multi-family offices, and single-family offices. The Funds are offered exclusively to non-US persons as defined under Regulation S under the Securities Act of 1933, as amended (the “Securities Act”), and United States persons who are accredited investors as defined under Regulation D under the Securities Act and qualified purchasers as defined under Section 2(a)(51) of the Investment Company Act of 1940, as amended (the “Investment Company Act”). Therefore the Funds are not required to register as investment companies under the Investment Company Act in reliance upon the exemption under Section 3(c)(7) for funds whose securities are not publicly offered.

Tolis may also provide investment management and supervisory services to Separate Account clients. Tolis’ Separate Account clients may invest in existing or future funds advised by Tolis.

Generally, investors must invest a minimum dollar amount of USD \$1,000,000 to invest in each Fund, subject to such minimum investment amount being waived by Tolis or the directors of the Fund (if applicable).

Tolis does not maintain written minimum initial investment criteria for its Separate Accounts. However, such services are directed towards institutional investors and high net worth individuals who are able to commit substantial sums of capital for longer durations, typically in excess of USD \$10 million per Separate Account.

Tolis is under no obligation to accept any client or any investor into the Funds and may decline acceptance of a client or investor in its sole discretion.

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

Methods of Analysis

Tolis is a multi-sector, multi-strategy structured credit asset manager that employs structured credit strategies as well as other strategies that are complementary to its structured credit strategies. Tolis invests primarily in Structured Credit Securities on behalf of its clients in an effort to generate attractive positive risk-adjusted cashflows. CDOs, and other Structured Credit Securities, may be collateralized by: RMBS, CMBS, ABS, leveraged loans, trust preferred securities, any other corporate credit securities or references to such securities, real estate investment trust (“REIT”) debt securities, debt from issuers domiciled in emerging market countries, or other assets (together, “collateral”). Tolis may make certain catalyst-driven investments on behalf of its clients which may involve investment realization over short or medium term horizons through non-traditional work-out strategies.

Tolis analyzes each investment idea from the unique perspective of its specific structured credit sector. Structured credit analysis requires an understanding of both the asset and liability sides of specific individual investment vehicles. Changes in the capital structures of such investment vehicles, how much cashflow they generate, when they generate cashflow, and which class of security will benefit from cashflow, are as important as the fluctuations in the performance and value of the underlying collateral. The attractiveness of specific investments can increase or decrease over time due to both the evolution of the underlying collateral and structural behavior. Tolis attempts to anticipate any such deviations that are skewed towards the positive end of the spectrum.

Tolis believes that each specific positive investment insight is not necessarily actionable, and that the correct view about the performance of a specific collateral sector is not meaningful if the view cannot be expressed. Tolis endeavors to make its investment process robust enough to sift through many unsuitable assets, even in a desired sector, either because of improper pricing or unfavorable structural features specific to an individual security, in order to determine if an investment is appropriate for its clients.

Tolis’ asset sourcing process originates from four broad areas: asset sector analysis and the interaction with broader macroeconomic factors, dealer inventory and dealer client assets, competitive auctions (including “Bids Wanted in Competition” or “BWIC”), and reverse inquiry.

Asset Sector Analysis; Interaction with Macroeconomic Factors - Tolis may note economy-wide factors that have specific interactions with the structured credit universe. For example, decreasing unemployment is typically associated with a lower foreclosure rate, and rising interest rates slow mortgage refinancing activity. This may provide certain insight as to whether to focus efforts on more credit sensitive securities, or convexity (speed of repayment) sensitive securities. However, it is important to note that Tolis’ approach is not macro based or reliant on econometric models. As described further below, while the macroeconomic environment is sometimes a helpful signal to determine which areas of structured credit are best to mine for attractive assets, the analysis Tolis undertakes as part of its investment process is fundamentally a process undertaken at the individual security level.

Dealer Inventory/Assets - Dealer inventory provides a specific subset of assets to analyze, the benefit of which is that they are usually actionable candidates. The drawback is that the prices are often not as

attractive as other sources.

Competitive Auctions - Assets purchased through competitive auctions are less likely to be excessively marked-up. The key to competitive auctions is to quickly and efficiently sift through the numerous line items to determine the most appropriate assets to analyze and on which potentially to bid. Tolis has developed screening models to help work through the large volumes of assets that may be auctioned in any given day.

Reverse Inquiry - Reverse inquiry is a process by which Tolis will task dealers with finding assets with a specific collateral type or profile. The instructions provided by Tolis to the dealers are often broad since these assets are only potential candidates for the actual analysis. Alternatively, Tolis may task dealers with finding a specific security at a specific price. When Tolis does this, it is usually because Tolis has already performed detailed analysis on an asset and knows that its performance attributes are favorable. In certain cases, Tolis filters through the statutory filings of regulated entities that are required to make public certain portfolio specific information, allowing Tolis to assign dealers to interact with those regulated entities to determine if assets which have passed Tolis' credit screens based on publicly available data are available to be purchased. Lastly, certain types of Structured Credit Securities may have other securities serving as underlying collateral. In these re-securitizations, in the process of analyzing the most senior level of the structure, Tolis may find collateral that is interesting and suitable for investment by itself, granting Tolis insight into a new area of inquiry that Tolis had not previously explored and providing Tolis with new opportunities to make attractive investments on behalf of its clients.

The asset sourcing process described above is essentially the first step in determining which assets are the most appropriate for Tolis to continue to research through the next level of its investment process. In the next stage of the process, Tolis endeavors to analyze the structural return profile of an investment. Tolis does this by building a financial model which simulates the payment profile of an asset under various scenarios of collateral credit performance and the resultant liability structure performance. The pools of assets collateralizing ABS (which are typically large and diverse) are well suited to a quantitative analysis of credit risk, providing a rigorous framework for investment selection. While some level of losses is expected on a pool of underlying assets, the objectives of the analysis are to simulate the extreme boundaries of credit performance in order to evaluate the dispersion of the return profile, and to determine a base case of the potential extent of losses and over what time period they will be incurred. Analysis of historical loan performance may reveal which loan characteristics are most influential and which are least influential, and allow for weighting of these characteristics as determinants of future losses on pools of collateral with comparable characteristics. In the case of certain Structured Credit Securities, losses do not normally occur all at once, as is the case with a default on a corporate bond, for example, and there may be an observable trend that can be derived from monthly reports. In less granular sectors such as CDOs and CMBS, Tolis is able to perform a loan-by-loan analysis and apply a line-by-line credit and stress analysis to the underlying collateral.

Following this credit risk analysis of the underlying collateral, Tolis may perform a simultaneous analysis of the credit enhancement mechanisms and expected loss vectors to determine break points of securities' yields with respect to losses. Credit enhancement can provide an additional margin of safety that allows a higher level of losses without decreasing the return of a security. Tolis will generally seek to make investments that either have a sufficient margin of safety to allow for protected returns during unfavorable

market environments or an efficient means of hedging returns in such environments.

As part of its investment process, Tolis will also review transaction documentation and the legal structure of Structured Credit Securities. Tolis believes that this allows it to gain a better understanding of the drivers of payment mechanics within a structure, and that this process may also highlight innovative monetization strategies in order to maximize monetization opportunities. This part of the investment process allows Tolis to evaluate covenant compliance with other stakeholders, such as the manager, servicer, arranger, or trustee of the underlying collateral in order to gain leverage in negotiations over the active steps that Tolis believes can be taken to positively influence transaction performance.

When ranking specific securities as candidates for potential investment, Tolis uses two broad profile buckets: “low volatility” assets and “high volatility” assets. Low volatility assets are often senior priority cashflows which have a stable return profile throughout the full credit stress spectrum. Assets of this type, with the narrowest dispersion of return, are ranked highest. These types of assets will serve as the baseline cashflow and carry of the portfolio, and thus stability of return is the most desired attribute once a baseline yield threshold is crossed. For high volatility assets, a wider dispersion of return is acceptable. In ranking the relative attractiveness of this return category, the return of capital in the downside case is more important than the potential upside return. Tolis does not believe that the upside return cases should be theoretical best case scenarios, but rather that there should be a meaningful probability that the target upside return can be achieved. Avoiding binary payoff profiles is important in all cases. In selecting an investment, Tolis seeks to avoid situations in which a failure in one step of the analysis leads to a significant loss of capital in such investment.

If an asset looks favorable after the entire analysis is complete, Tolis will further negotiate the price of the asset with a seller (unless it is an auction where there are no such direct negotiations) in an effort to increase the amount of potential returns that can be obtained. If the price at which Tolis views an asset as attractive intersects with the price at which Tolis can purchase such asset on behalf of its clients, Tolis will seek to execute the trade.

Material Risks

Although investments in Structured Credit Securities and related strategies may result in significant returns to the clients of Tolis, they also involve a substantial degree of risk. Tolis generally accepts only clients that are able to bear the financial risk of the investment strategy for an indefinite period of time and are able to sustain the loss of all or a significant part of their investment.

The investment strategy employed by Tolis on behalf of its clients involves significant risks. Prospective clients and investors in the Funds should carefully review the risks described in the Governing Documents for the relevant Fund, and should evaluate the merits and risks of an investment in the context of their overall financial circumstances. The risk factors below are not intended to be exhaustive and should be considered carefully by prospective investors or clients together with the full text of the applicable governing document or client agreement.

Dependence upon Other Unrelated Third Parties - The success of each structured finance investment may depend on the actions of others. For certain mortgage-related assets, a servicer or special servicer

unrelated to Tolis is tasked with managing delinquent loans, potentially modifying loan terms, or repossessing and disposing of real properties. ABS may involve exposure to portfolios of receivables that are dependent on the performance of managers and employees of the entity which originated and transferred these receivables to the ABS issuer. CDOs are often managed. These CDO managers may be dependent on the talents and efforts of one person or a small group of persons whose loss could adversely affect the CDO. Due to the fact that Tolis will not have an active role in the management of the CDOs, the return on investments in such CDOs will depend on the performance of unrelated managers.

Subprime Mortgages - Tolis may invest in securities backed primarily (potentially up to 100%) by subprime mortgages. The concentration in subprime mortgages may be a significant risk to the performance of the portfolio if the underlying assets underperform. In past periods of distress, subprime mortgages exhibited especially high correlations of performance which should be considered in addition to the risks specific with any one security. Furthermore, the potential concentration of such subprime RMBS within a specific CDO may create additional unique risks to the performance of the CDO. In the event that subprime mortgages as a group dramatically underperform, the concentration of such risk in the CDO may be magnified.

Investments in Distressed Securities - Tolis may invest in “below investment grade” securities and obligations of issuers in weak financial condition, experiencing poor operating results, having substantial capital needs or negative net worth, or involved in bankruptcy or other reorganization and liquidation proceedings. These securities are likely to be particularly risky investments, although they may also offer the potential for correspondingly high returns. Among the risks inherent in investments in troubled entities is the fact that it frequently may be difficult to obtain information as to the true condition of such issuers. Such investments may also be adversely affected by laws relating to, among other things, fraudulent transfers and other voidable transfers or payments, lender liability and the bankruptcy court’s power to disallow, reduce, subordinate or disenfranchise particular claims. Such companies’ securities may be considered speculative, and the ability of such companies to pay their debts on schedule could be affected by adverse interest rate movements, changes in the general economic climate, economic factors affecting a particular industry or specific developments within such companies. In addition, there is no minimum credit standard that is a prerequisite to an investment in any instrument, and a significant portion of the obligations and securities in which Tolis may invest may be lower than investment grade. Any one or all of the issuers of the securities in which Tolis may invest may be unsuccessful or not show any returns for a considerable period of time. The level of analytical sophistication, both financial and legal, necessary for successful investment in companies experiencing significant business and financial difficulties is unusually high. There is no assurance that Tolis will correctly evaluate the value of the assets collateralizing loans or the prospects for a successful reorganization or similar action. In any reorganization or liquidation proceeding relating to a company in which Tolis invests, clients may lose their entire investment, may be required to accept cash or securities with a value less than their original investment and/or may be required to accept payment over an extended period of time. Under such circumstances, the returns generated from investments may not compensate investors adequately for the risks assumed.

In liquidation (both in and out of bankruptcy) and other forms of corporate reorganization, there exists the risk that the reorganization will be unsuccessful (due to, for example, failure to obtain requisite approvals), will be delayed (for example, until various liabilities, actual or contingent, have been satisfied) or will result in a distribution of cash or a new security, the value of which will be less than the purchase price of

the security in respect to which such distribution was made.

In certain transactions, client accounts may not be “hedged” against market fluctuations, or, in liquidation situations, may not accurately value the assets of the company being liquidated. This can result in losses, even if the proposed transaction is consummated.

Distressed Structured Securities - Tolis may invest in distressed structured securities, including ABS, RMBS, CMBS and CDOs. Generally, such securities can be categorized as distressed securities for various reasons, including, for example, the weak performance and financial health of the issuer and/or servicer, the under-performance of the underlying collateral, or issues relating to structural characteristics and features of the transaction. When accounting for the purchase price of such securities, Tolis will endeavor to determine whether the cash flows from the security in question, given the purchase price (which will likely be but need not be a discount to par), will generate a yield that meets the investment target. The estimate made by Tolis with respect to the likelihood and timing of future cash flows may be imprecise and likely to change over time. If the actual cash flows realized in respect of an investment are materially lower than the forecast or are received later than as forecasted, notwithstanding a discounted purchase price, such investment will produce a lower than expected and potentially negative return. Any leverage will amplify any negative outcomes.

Possible Subordination of Structured Credit Securities - Client portfolios may consist primarily of Structured Credit Securities which might be subordinate. Subordinate debt generally is fully subordinated to the related senior tranches. CDO equity and other first loss tranches generally are fully subordinated to any related issuer debt. To the extent that any losses are incurred by a transaction in respect of its related collateral, such losses will be borne first by the holders of the related first loss piece, next by the holders of any related subordinated debt and finally by the holders of the related senior tranches. In addition, if an event of default occurs under the governing instrument or underlying investment, as long as any senior tranches are outstanding, the holders thereof generally will be entitled to determine the remedies to be exercised under the instrument governing the transaction. Remedies pursued by such holders could be adverse to the interests of the holders of any related subordinated debt and/or the holders of the related first loss piece, as applicable.

First Loss Investments - Certain deeply subordinated investments may be adversely affected from a single default or other instance of collateral underperformance. Examples such as residual certificates, preference shares or CDO equity may not be secured by the applicable collateral. As such, the holders of these investments will rank behind all of the creditors, whether secured or unsecured and known or unknown, of the applicable issuer. To the extent the issuer is a Cayman Islands entity, which is often the case, amounts will be payable only if the issuer has sufficient distributable profits under Cayman Islands law. In addition, such distributions will be payable out of the share premium account only to the extent that the issuer is and remains solvent after such distributions are paid. Under Cayman Islands law, an issuer is generally deemed to be solvent for such purposes if it is able to pay its debts as they become due in the ordinary course of its business immediately after making such payment. To the extent the requirements under Cayman Islands law described above are not met, amounts otherwise payable will not be paid until the payment date on which such requirements are met.

Volatility of Structured Credit Securities; Leveraged Investment - Structured Credit Securities represent

leveraged investments in the collateral underlying the transaction. The mechanics of tranching classes into various payment priorities may amplify potential variations of outcomes. It is possible that Tolis could purchase either the most or one of the most subordinate tranches of the issuer's securities, which is the most leveraged investment in a transaction. In such cases, it is expected that changes in the value of the Structured Credit Securities will be greater than the change in the value of the applicable collateral, which is also subject to credit, liquidity, interest rate and other risks. Unlike financial leverage, which typically involves borrowing funds to apply towards the purchase of a security, this structural leverage can have similar effects on investment performance. While structural leverage presents opportunities for increasing total return, it has the effect of potentially increasing losses as well. Utilization of leverage is a speculative investment technique and involves certain risks to investors. The cumulative effect of the use of leverage by a Structured Credit Security in a market that moves adversely to the collateral underlying such Structured Credit Security could result in a substantial loss to the Structured Credit Security which would be greater than a direct investment in the underlying assets.

Illiquidity of Structured Credit Securities Owned by the Clients - The value of Structured Credit Securities will fluctuate with, among other things, changes in the market rates of interest, general economic conditions, economic conditions in particular industries, the condition of financial markets and the financial condition of the actual transaction. In addition, the lack of an established, liquid secondary market for some Structured Credit Securities (first loss investments in particular) may have an adverse effect on the market value of those Structured Credit Securities, and will in most cases make it difficult to dispose of such Structured Credit Securities at market or near market prices. The public markets for Structured Credit Securities have experienced periods of volatility and periods of reduced liquidity, and Structured Credit Securities will be subject to certain other transfer restrictions that may contribute to illiquidity. Therefore, if a client decides to dispose of any particular Structured Credit Security, no assurance can be given that it will be able to dispose of such Structured Credit Security at the prevailing market price. Such illiquidity may adversely affect the price and timing of liquidations of Structured Credit Securities.

Mandatory and Option Redemption - Under certain circumstances, cash flows from a structured credit transaction's underlying collateral that otherwise would have been paid to the holders of Structured Credit Securities under the regular priority of payments will be used to redeem the senior tranches. This could result in an elimination, deferral or reduction in the interest payments, principal repayments or other payments made to the other holders of securities in the specific transaction, which could adversely impact the returns to such holders. An unrelated third-party may own an optional redemption right requiring the liquidation of collateral positions more rapidly than would otherwise be desirable, which could adversely affect the realized value of the items of collateral sold (and which in turn could adversely impact the other holders of classes in a transaction).

Concentration Risk - Structured Credit Securities may possess concentrated portfolios of assets. The concentration of an underlying portfolio in any one obligor would subject the related Structured Credit Securities (the related first loss class in particular) to a greater degree of risk with respect to defaults by such obligor, and the concentration of a portfolio in any one industry would subject the related Structured Credit Securities (the related first loss class in particular) to a greater degree of risk with respect to economic downturns relating to such industry.

Interest Rate Mismatch - Structured Credit Securities may be subject to interest rate risk. The collateral

underlying an issuer may bear interest at a fixed (floating) rate, while the issued security may bear interest at a floating (fixed) rate. As a result, there could be a floating/fixed rate or basis mismatch between such securities and the underlying collateral which bear interest at a fixed rate (“Fixed Rate Assets”), and there may be a timing mismatch between such securities and the assets that are not Fixed Rate Assets (“Floating Rate Assets”). In addition, the interest rate on Floating Rate Assets may adjust more frequently or less frequently, on different dates and based on different indices than the interest rates on the issued securities. As a result of such mismatches, an increase or decrease in the level of the floating rate indices could adversely impact the ability to make payments on such securities.

Insolvency Risks - Various laws enacted for the protection of creditors may apply to the issuers of or collateral underlying Structured Credit Securities (solely for purposes of this risk factor, an “Insolvent Company”). The information in this paragraph and the following paragraph is applicable with respect to U.S. issuers of structured credit collateral. Insolvency considerations may differ with respect to non-U.S. issuers of structured credit collateral. If a court in a lawsuit brought by an unpaid creditor or representative of creditors of an Insolvent Company, such as a trustee in bankruptcy, were to find that the issuer did not receive fair consideration or reasonably equivalent value for incurring the indebtedness constituting the structured credit issuer or structured credit collateral (as applicable) and, after giving effect to such indebtedness, the Insolvent Company (i) was insolvent, (ii) was engaged in a business for which the remaining assets of the Insolvent Company constituted unreasonably small capital or (iii) intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature, such court could determine to invalidate, in whole or in part, such indebtedness as a fraudulent conveyance, to subordinate such indebtedness to existing or future creditors of the Insolvent Company, or to recover amounts previously paid by such issuer in satisfaction of such indebtedness. The measure of insolvency for purposes of the foregoing will vary. Generally, an Insolvent Company would be considered insolvent at a particular time if the sum of its debts were greater than all of its property at a fair valuation, or if the present fair saleable value of its assets were less than the amount that would be required to pay its probable liabilities on its existing debts as they became absolute and matured. There can be no assurance as to what standard a court would apply in order to determine whether the Insolvent Company was “insolvent” after giving effect to the incurrence of the indebtedness constituting the Structured Credit Security or the Structured Credit Security collateral or that, regardless of the method of valuation, a court would not determine that the Insolvent Company was “insolvent” upon giving effect to such incurrence. In addition, in the event of the insolvency of an Insolvent Company, payments made on such Structured Credit Security or Structured Credit Security collateral could be subject to avoidance as a “preference” if made within a certain period of time (which may be as long as one year) before insolvency.

In general, if payments on a Structured Credit Security or Structured Credit Security collateral are avoidable, whether as fraudulent conveyances or preferences, such payments can be recaptured either from the initial recipient or from subsequent transferees of such payments. However, a court in a bankruptcy or insolvency proceeding would be able to direct the recapture of any such payment from a Shareholder only to the extent that such court has jurisdiction over such holder or its assets. Moreover, it is likely that avoidable payments could not be recaptured directly from a holder that has given value in exchange for its interest, in good faith and without knowledge that the payments were avoidable. Nevertheless, there can be no assurance that a Shareholder will be able to avoid recapture on this or any other basis.

“Widening” Risk - For reasons not necessarily attributable to any of the risks described herein (for

example, supply/demand imbalances or other market forces), the prices of Structured Credit Securities may decline substantially. In particular, purchasing assets at what may appear to be “undervalued” levels is no guarantee that these assets will not be trading at even lower levels at a time of valuation or at the time of sale. It may not be possible to predict, or to hedge against, such “spread widening” risk.

Nature of Structured Credit Collateral - Collateral underlying Structured Credit Securities is subject to credit, market, liquidity and interest rate risk. When a transaction is initially structured, it is generally established to withstand certain assumed declines in market value with respect to its collateral. If any declines exceed such assumed levels, however, payments on the Structured Credit Securities could be adversely affected. To the extent that a default occurs with respect the collateral, and it is sold or otherwise disposed of within a structured finance structure, it is not likely that the proceeds of such sale or disposition will be equal to the amount of principal and interest owed to the structure with respect to such collateral.

Reliable sources of statistical information do not exist with respect to the default rates for many types of collateral. In addition, historical economic performance of a particular type of collateral is not necessarily indicative of its future performance. The market value of the collateral generally will fluctuate with, among other things, the financial condition of the obligors of the collateral, general economic conditions, the condition of certain financial markets, political events, developments or trends in any particular industry, and changes in prevailing interest rates. Current interest rates are at very low levels (compared to the levels before the onset of the period of global financial distress); in the event that such interest rates increase, the market value of collateral may be more volatile.

CDO and CLO issuers may find that, as a practical matter, investment opportunities are not available to them for a variety of reasons. At any time there may be a limited universe of investments that would satisfy the investment requirements of a particular CDO or CLO. CDO collateral may consist of high yield debt securities, loans, ABS, MBS and other instruments, which often are rated below investment grade (or of equivalent credit quality).

Price Volatility Risk - The prices of Structured Credit Securities are highly volatile. Price movements are influenced by, among other things: changing supply and demand relationships; trade, fiscal, monetary and exchange control programs and policies of governments; United States and foreign political events and policies; changes in national and/or international interest rates and rates of inflation; currency devaluations and revaluations, and market sentiments.

Adjustable Rate Mortgage-Backed Securities and Floating Rate CMOs - Certain mortgage-backed securities are backed by adjustable rate loans. The market value of adjustable rate mortgage securities may be adversely affected if the mortgage loans underlying these securities contain provisions limiting the amount by which their rates may be adjusted upward (periodic rate caps) in response to rising interest rates, or limiting the amount by which payments may be increased to accommodate upward adjustments in interest rates (periodic payment caps). The market value of adjustable rate securities may also be adversely affected to the extent that mortgages are subject to lifetime rate caps.

Certain CMOs pay interest rates which float in direct or inverse relation to an underlying reference rate. These securities are typically backed by fixed rated mortgage loans. Most floating rate and inverse floating

rate CMOs are subject to lifetime rate caps and floors, which may also adversely affect their returns in certain rate environments. In addition, since they are backed by fixed rate mortgage collateral, their returns may also be affected by the prepayment behavior of the underlying fixed rate mortgages. Certain CMO tranches may, through structural features, leverage both prepayment risk and the sensitivity of coupon return to rate changes.

Residential Mortgage-Backed Securities - Holders of RMBS bear various risks, including credit, market, interest rate, structural and legal risks. RMBS represent interests in pools of residential mortgage loans secured by one to four family residential mortgage loans. Such loans may be prepaid at any time. Residential mortgage loans are obligations of the borrowers thereunder only and are not typically insured or guaranteed by any other person or entity, although such loans may be securitized by government agencies and the securities issued are guaranteed. The rate of defaults and losses on residential mortgage loans will be affected by a number of factors, including general economic conditions and those in the area where the related mortgaged property is located, the borrower's equity in the mortgaged property and the financial circumstances of the borrower. If a residential mortgage loan is in default, foreclosure of such residential mortgage loan may be a lengthy and difficult process, and may involve significant expenses. Furthermore, the market for defaulted residential mortgage loans or foreclosed properties may be very limited.

At any one time, a portfolio of RMBS may be backed by residential mortgage loans with disproportionately large aggregate principal amounts secured by properties in only a few states or regions. As a result, the residential mortgage loans may be more susceptible to geographic risks relating to such areas, such as adverse economic conditions, adverse events affecting industries located in such areas and natural hazards affecting such areas, than would be the case for a pool of mortgage loans having more diverse property locations. In addition, the residential mortgage loans often include so called "jumbo" mortgage loans, having original principal balances that are higher than the Fannie Mae and Freddie Mac loan balance limitations. As a result, such portfolio of RMBS may experience increased losses.

Prepayments on the underlying residential mortgage loans in an issue of RMBS will be influenced by the prepayment provisions of the related mortgage notes and may also be affected by a variety of economic, geographic and other factors, including the difference between the interest rates on the underlying residential mortgage loans (giving consideration to the cost of refinancing) and prevailing mortgage rates and the availability of refinancing. In general, if prevailing interest rates fall significantly below the interest rates on the related residential mortgage loans, the rate of prepayment on the underlying residential mortgage loans would be expected to increase. Conversely, if prevailing interest rates rise to a level significantly above the interest rates on the related mortgages, the rate of prepayment would be expected to decrease. Prepayments could reduce the yield received on the related issue of RMBS. RMBS are particularly susceptible to prepayment risks as they generally do not contain prepayment penalties and a reduction in interest rates will increase the prepayments on the RMBS, resulting in a reduction in yield to maturity for holders of such securities.

RMBS may be backed by non-conforming mortgage loans, which are mortgage loans that do not qualify for purchase by government-sponsored agencies such as Fannie Mae and Freddie Mac because of credit characteristics that do not satisfy Fannie Mae and Freddie Mac guidelines, including loans to mortgagors whose creditworthiness and repayment ability do not satisfy Fannie Mae and Freddie Mac underwriting

guidelines and loans to mortgagors who may have a record of credit write-offs, outstanding judgments, prior bankruptcies and other negative credit items. Accordingly, non-conforming mortgage loans are likely to experience rates of delinquency, foreclosure and loss that are higher, and that may be substantially higher, than mortgage loans originated in accordance with Fannie Mae or Freddie Mac underwriting guidelines. The majority of mortgage loans made in the United States qualify for purchase by government-sponsored agencies. The principal differences between conforming mortgage loans and non-conforming mortgage loans include the applicable loan-to-value ratios, the credit and income histories of the related mortgagors, the documentation required for approval of the related mortgage loans, the types of properties securing the mortgage loans, the loan sizes and the mortgagors' occupancy status with respect to the mortgaged properties. As a result of these and other factors, the interest rates charged on non-conforming mortgage loans are often higher than those charged for conforming mortgage loans. The combination of different underwriting criteria and higher rates of interest may also lead to higher delinquency, foreclosure and losses on non-conforming mortgage loans as compared to conforming mortgage loans.

RMBS may contain certain credit enhancement features intended to enhance the likelihood that holders of such securities will receive regular payments of interest and principal. If delinquencies or defaults occur on the mortgage loans underlying such RMBS, neither the related servicers nor any other entities will advance scheduled monthly payments of interest and principal on delinquent or defaulted mortgage loans if such advances are not likely to be recovered within those transactions. There can be no assurance that the credit enhancement, if any, applicable to RMBS owned by a CDO Security will adequately cover any shortfalls in cash available to make payments on such RMBS as a result of such delinquencies or defaults. If substantial losses occur as a result of defaults and delinquent payments on the mortgage loans, the related CDO Security may suffer losses with respect to its ownership of such RMBS.

The increase in monthly payments on adjustable rate mortgage loans may result in higher delinquency rates. Borrowers with adjustable rate mortgage loans are being exposed to increased monthly payments when the related mortgage interest rate adjusts upward from the initial fixed rate or a low introductory rate. Borrowers seeking to avoid these increased monthly payments by refinancing their mortgage loans may no longer be able to find available replacement loans at comparably low interest rates. A decline in housing prices may also leave borrowers with insufficient equity in their homes to permit them to refinance. Furthermore, borrowers who intend to sell their homes on or before the expiration of the fixed rate periods on their mortgage loans may find that they cannot sell their properties for an amount equal to or greater than the unpaid principal balance of their loans. These events, alone or in combination, may contribute to higher delinquency rates and, as a result, adversely affect the performance and market value of RMBS and CDO Securities backed by RMBS.

RMBS may provide that the servicer is required to make advances in respect of delinquent mortgage loans. However, servicers experiencing financial difficulties may not be able to perform these obligations. Servicers who have sought bankruptcy protection may, due to application of the provisions of bankruptcy law, not be required to advance such amounts. Even if a servicer were able to advance amounts in respect of delinquent mortgage loans, its obligation to make such advances may be limited to the extent that it does not expect to recover such advances due to the deteriorating credit of the delinquent mortgage loans. In addition, a servicer's obligation to make such advances may be limited to the amount of its servicing fee.

In addition, numerous residential mortgage loan originators and servicers that originate and service

subprime mortgage loans have recently experienced serious financial difficulties and, in some cases, bankruptcy. Those difficulties have resulted in part from declining markets for mortgage loans as well as from claims for repurchases of mortgage loans previously sold under provisions that require repurchase in the event of early payment defaults, or for material breaches of representations and warranties made on the mortgage loans, such as fraud claims. Such financial difficulties may have a negative effect on the ability of servicers to pursue collection on mortgage loans that are experiencing increased delinquencies and defaults and to maximize recoveries on sale of underlying properties following foreclosure. The inability of the originator to repurchase such mortgage loans in the event of early payment defaults and loan representation breaches may also affect the performance of RMBS backed by those mortgage loans. These difficulties may adversely affect the performance and market value of RMBS originated, serviced or subserviced by these companies. As a result, the performance and market value of CDO Securities backed by RMBS also may be adversely affected.

Under certain circumstances, including a failure to perform its servicing obligations or a bankruptcy of the servicer and, in some cases, certain loss and/or delinquency triggers being exceeded, investors will be entitled to remove and replace the existing servicer. There is no guarantee, however, that a suitable servicer could be found to assume the obligations of the existing servicer, and the transition of servicing responsibilities to a replacement servicer could have an adverse effect on performance of servicing functions during or following a transition period and result in an increase in delinquencies and losses and a decrease in recoveries.

RMBS may be subordinated to one or more other senior classes of securities of the same series for purposes of, among other things, offsetting losses and other shortfalls with respect to the related underlying mortgage loans. In addition, in the case of certain RMBS, no distributions of principal will generally be made with respect to any class until the aggregate principal balances of the corresponding senior classes of securities have been reduced to zero. As a result, the subordinate classes are more sensitive to risk of loss and write-downs than senior classes of such securities.

Violations of consumer protection laws may result in losses on RMBS. Applicable state laws generally regulate interest rates and other charges, require licensing of originators and require specific disclosures. In addition, other state laws, public policy and general principles of equity relating to the protection of consumers, unfair and deceptive practices and debt collection practices may apply to the origination, servicing and collection of the loans backing RMBS. Depending on the provisions of the applicable law and the specific facts and circumstances involved, violations of these laws, policies and principles may limit the ability of the issuer of a RMBS to collect all or part of the principal of or interest on the underlying loans, may entitle a borrower to a refund of amounts previously paid and, in addition, could subject the owner of a mortgage loan to damages and administrative enforcement.

Some of the mortgages loans backing a RMBS may have been underwritten with, and finance the cost of, credit insurance. From time to time, originators of mortgage loans that finance the cost of credit insurance have been named in legal actions brought by federal and state regulatory authorities alleging that certain practices employed relating to the sale of credit insurance constitute violations of law. If such an action was brought against such issuer with respect to mortgage loans backing such RMBS and was successful, it is possible that the borrower could be entitled to refunds of amounts previously paid or that such issuer could be subject to damages and administrative enforcement.

In addition, numerous federal and state statutory provisions, including the federal bankruptcy laws and state debtor relief laws, also may adversely affect the ability of an issuer of a RMBS to collect the principal or interest on the loans, and holders of the affected RMBS may suffer a loss if the applicable laws result in these loans becoming uncollectible.

ABS and MBS - General - The investment characteristics of ABS and MBS differ from traditional debt securities. Among the major differences are that interest and principal payments are made more frequently, usually monthly, and that the principal may be prepaid at any time because the underlying loans or other assets generally may be prepaid at any time.

Prepayment Risk - The frequency at which prepayments (including voluntary prepayments by the obligors and liquidations due to default and foreclosures) occur on loans underlying MBS and ABS will be affected by a variety of factors including the prevailing level of interest rates as well as economic, demographic, tax, social, legal and other factors. Generally, mortgage obligors tend to prepay their mortgage loans when prevailing mortgage rates fall below the interest rates on their mortgage loans. Although ABS are generally less likely to experience substantial prepayments than MBS, certain of the factors that affect the rate of prepayments on MBS also affect the rate of prepayments on ABS. However, during any particular period, the predominant factors affecting prepayment rates on MBS and ABS may be different.

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

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

Index Risk - Tolis may also invest in structured notes and variable rate MBS and ABS, including adjustable-rate mortgage securities, which are backed by mortgages with variable rates, the rate of interest payable under which varies with a designated rate or index. The value of these investments is closely tied to the absolute levels of such rates or indices, or the market’s perception of anticipated changes in those rates or indices. This introduces additional risk factors related to the movements in specific indices or interest rates that may be difficult or impossible to hedge, and that also interact in a complex fashion with prepayment risks.

Subordinated Securities - Investments in subordinated MBS and ABS involve greater credit risk of default than the senior classes of the issue or series. Default risks may be further pronounced in the case of MBS and ABS secured by, or evidencing an interest in, a relatively small or less diverse pool of underlying

loans. Certain subordinated securities absorb all losses from default before any other class of securities is at risk, particularly if such securities have been issued with little or no credit enhancement or equity. Such securities therefore possess some of the attributes typically associated with equity investments.

ABS - Through the use of trusts and special purpose corporations, various types of assets, primarily automobile and credit card receivables, are securitized in pass-through structures. Tolia may invest in these and other types of ABS that may be developed in the future. ABS are securities that entitle the holders thereof to receive payments that depend primarily on the cash flow from, or market value of, a specified pool of financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, together with rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of ABS.

Credit risk is an important issue in ABS because of the significant credit risks inherent in the underlying collateral and because issuers are primarily private entities. The structure of ABS and the terms of the investors' interest in the collateral can vary widely depending on the type of collateral, the desires of investors and the use of credit enhancements. Although the basic elements of all ABS are similar, individual transactions can differ markedly in both structure and execution. Important determinants of the risk associated with issuing or holding the securities include the process by which principal and interest payments are allocated and distributed to investors, how credit losses affect the issuing vehicle and the return to investors in such ABS, whether collateral represents a fixed set of specific assets or accounts, whether the underlying collateral assets are revolving or closed-end, under what terms (including maturity of the asset-backed instrument) any remaining balance in the accounts may revert to the issuing entity and the extent to which the entity that is the actual source of the collateral assets is obligated to provide support to the issuing vehicle or to the investors in such ABS.

Holders of ABS bear various risks, including credit risks, liquidity risks, interest rate risks, market risks, operations risks, structural risks and legal risks. Credit risk arises from losses due to defaults by the obligors on the underlying collateral and the issuer's or servicer's failure to perform. These two elements can blur together as, for example, in the case of a servicer who does not provide adequate credit-review scrutiny to the serviced portfolio, leading to a higher incidence of defaults. ABS are generally rated by nationally recognized rating agencies. Market risk arises from the limited market for such securities and the cash-flow characteristics of such securities. One variability in cash flows comes from credit performance, including the presence of wind-down or acceleration features designed to protect the investor in the event that credit losses in the portfolio rise well above expected levels. Interest rate risk arises for the issuer from the relationship between the pricing terms on the underlying assets and the terms of the rate paid to security holders and from the need to mark to market the excess servicing or spread account proceeds carried on the balance sheet. For the holder of the security, interest rate risk depends on the expected life or repricing of the ABS, with relatively minor risk arising from embedded options. Liquidity risk can arise from increased perceived credit risk. Operational risk arises through the potential for misrepresentation of asset quality or terms by the originating institution, misrepresentation of the nature and current value of the assets by the servicer and inadequate controls over disbursements and receipts by the servicer. Legal risk can arise as a result of the procedures followed in connection with the origination of the underlying assets or the servicing thereof.

ABS may be subordinate in right of payment and rank junior to other securities that are secured by or

represent an ownership interest in the same pool of assets. In addition, many transactions may have structural features that divert payments of interest and/or principal to more senior classes when the delinquency or loss experience of the pool exceeds certain levels. As a result, such securities may have a higher risk of loss as a result of delinquencies or losses on the underlying assets. In certain circumstances, payments of interest may be reduced or eliminated for one or more payment dates. Additionally, as a result of cash flow being diverted to payments of principal on more senior classes, the average life of such securities may lengthen. For example, in the case of certain ABS residential securities, no distributions of principal will generally be made with respect to any class until the aggregate principal balances of the more senior classes of securities have been reduced to zero. Subordinate ABS generally do not have the right to call a default or vote on remedies following a default unless more senior securities have been paid in full. As a result, a shortfall in payments to subordinate investors in ABS will generally not result in a default being declared on the transaction and the transaction will not be restructured or unwound. Furthermore, because subordinate ABS may represent a relatively small percentage of the size of the asset pool being securitized, the impact of a relatively small loss on the overall pool may be substantial to the holders of such subordinate securities.

The market value of ABS will generally fluctuate with, among other things, changes in prevailing interest rates, general economic conditions, the condition of certain financial markets, international political events, developments or trends in any particular industry, the financial condition of the issuer of the ABS and the obligors of the securitized assets underlying the ABS, and the terms of the ABS. Adverse changes in the financial condition of the issuers of the ABS or the obligors of the securitized assets underlying the ABS or in general economic conditions or both may result in a decline in the market value of the ABS. In addition, future periods of uncertainty in the United States' economy and the economies of other countries in which issuers of the ABS (or the obligors of the securitized assets underlying the ABS) are domiciled and the possibility of increased volatility and default rates may also adversely affect the price and liquidity of the ABS.

Many ABS will have no, or only a limited, trading market. Trading in fixed income securities in general, including ABS and derivatives thereof, takes place primarily in over-the-counter markets consisting of groups of dealer firms that are typically major securities firms. Because the market for certain ABS and derivatives thereof is a dealer market, rather than an auction market, no single obtainable price for a given instrument prevails at any given time. Not all dealers maintain markets in all ABS at all times. The illiquidity of ABS may restrict investors' ability to take advantage of market opportunities. Illiquid ABS may trade at a discount from comparable, more liquid investments. In addition, ABS may include privately placed securities that may or may not be freely transferable under the laws of the applicable jurisdiction or due to contractual restrictions on resale, and even if such privately placed securities are transferable, the value of such ABS could be less than what may be considered the fair value of such securities.

Some or all of the loans underlying ABS (and RMBS) may be prepaid at any time. Defaults on and liquidations of the loans underlying ABS or RMBS may also lead to early repayment thereof. Prepayments on loans may be affected by a number of factors. If prevailing rates for similar loans fall below the interest rates on such loans, prepayment rates would generally be expected to increase. Conversely, if prevailing rates for similar loans rise above the interest rates on such loans, prepayment rates would generally be expected to decrease.

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

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

CMBS - Mortgage loans on commercial properties often are structured so that a substantial portion of the loan principal is not amortized over the loan term but is payable at maturity and repayment of the loan principal thus often depends upon the future availability of real estate financing from the existing or an alternative lender and/or upon the current value and salability of the real estate. Therefore, the unavailability of real estate financing may lead to default.

Commercial mortgage loans underlying CMBS are generally secured by multi-family or commercial property and may entail risks of delinquency and foreclosure, and risks of loss in the event thereof that are greater than similar risks associated with loans secured by single-family residential property. The ability of a borrower to repay a loan secured by an income-producing property typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced (for example, if rental or occupancy rates decline or real estate tax rates or other operating expenses increase), the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things, tenant mix, success of tenant businesses, property management decisions (including responding to changing market conditions, planning and implementing rental or pricing structures and causing maintenance and capital improvements to be carried out in a timely fashion), property location and condition, competition from comparable types of properties, changes in laws that increase operating expense or limit rents that may be charged, any need to address environmental contamination at the property and the occurrence of any uninsured casualty at the property.

The value of an income-producing property is directly related to the net operating income derived from such property. Furthermore, the value of any commercial property may be adversely affected by risks

generally incident to interests in real property, including various events which the related borrower and/or manager of the commercial property, the issuer, the depositor, the indenture trustee, the master servicer or the special servicer may be unable to predict or control, such as: changes in general or local economic conditions and/or specific industry segments; declines in real estate values; declines in rental or occupancy rates; increases in interest rates, real estate tax rates and other operating expenses; changes in governmental rules, regulations and fiscal policies, including environmental legislation; acts of God; environmental hazards; and social unrest and civil disturbances.

Additional risks may be presented by the type and use of a particular commercial property. For instance, commercial properties that operate as hospitals and nursing homes may present special risks to lenders due to the significant governmental regulation of the ownership, operation, maintenance and financing of health care institutions. Hotel and motel properties are often operated pursuant to franchise, management or operating agreements which may be terminable by the franchisor or operator; and the transferability of a hotel's operating, liquor and other licenses upon a transfer of the hotel, whether through purchase or foreclosure, are subject to local law requirements.

Furthermore, a commercial property may not readily be converted to an alternative use in the event that the operation of such commercial property for its original purpose becomes unprofitable for any reason. In such cases, the conversion of the commercial property to an alternative use would generally require substantial capital expenditures. Thus, if the borrower becomes unable to meet its obligations under the related commercial mortgage loan, the liquidation value of any such commercial property may be substantially less, relative to the amount outstanding on the related commercial mortgage loan, than would be the case if such commercial property were readily adaptable to other uses.

Most commercial mortgage loans underlying CMBS are effectively nonrecourse obligations of the borrower, meaning that there is no recourse against the borrower's assets other than the collateral. If borrowers are not able or willing to refinance or dispose of encumbered property to pay the principal and interest owed on such mortgage loans, payments on the subordinated classes of the related CMBS are likely to be adversely affected. The ultimate extent of the loss, if any, to the subordinated classes of CMBS may only be determined after a negotiated discounted settlement, restructuring or sale of the mortgage note, or the foreclosure (or deed in lieu of foreclosure) of the mortgage encumbering the property and subsequent liquidation of the property. Foreclosure can be costly and delayed by litigation and/or bankruptcy. Factors such as the property's location, the legal status of title to the property, its physical condition and financial performance, environmental risks, and governmental disclosure requirements with respect to the condition of the property may make a third party unwilling to purchase the property at a foreclosure sale or to pay a price sufficient to satisfy the obligations with respect to the related CMBS. Revenues from the assets underlying such MBS may be retained by the borrower and the return on investment may be used to make payments to others, maintain insurance coverage, pay taxes or pay maintenance costs. Such diverted revenue is generally not recoverable without a court-appointed receiver to control collateral cash flow.

REIT Debt Securities - REIT Debt Securities consist of obligations of REITs or qualified REIT subsidiaries meeting the eligibility criteria described herein. Investments in REIT Debt Securities involve special risks. In particular, REITs and qualified REIT subsidiaries (all discussion concerning the risks relating to REITs herein being generally applicable to such subsidiaries) generally are permitted to invest

solely in real estate or real estate related assets and are subject to the inherent risks associated with such investments. Consequently, the financial condition of any REIT may be affected by the risks described above with respect to commercial mortgage loans and mortgage-backed securities and similar risks, including (i) risks of delinquency and foreclosure and risks of loss in the event thereof, (ii) the dependence upon the successful operation of and net income from real property, (iii) risks generally incident to interests in real property, including those described above, (iv) risks that may be presented by the type and use of a particular commercial property and (v) the difficulty of converting certain property to an alternative use in the event that the operation of such commercial property for its original purpose becomes unprofitable for any reason.

In addition, risks of REIT Debt Securities may include (among other risks) (i) limited liquidity and secondary market support, (ii) substantial market price volatility resulting from changes in prevailing interest rates, (iii) subordination to the prior claims of banks and other senior lenders, (iv) the possibility that earnings of the REIT Debt Security issuer may be insufficient to meet its debt service and (v) the declining creditworthiness and potential for insolvency of the issuer of such REIT Debt Securities during periods of rising interest rates and economic downturn. An economic downturn or an increase in interest rates could severely disrupt the market for REIT Debt Securities and adversely affect the value of outstanding REIT Debt Securities and the ability of the issuers thereof to repay principal and interest.

Issuers of REIT Debt Securities may be highly leveraged and may not have available to them more traditional methods of financing. The risk associated with acquiring the securities of such issuers generally is greater than is the case with highly rated securities. For example, during an economic downturn or a sustained period of rising interest rates, issuers of REIT Debt Securities may be more likely to experience financial stress, especially if such issuers are highly leveraged. During such periods, timely service of debt obligations may also be adversely affected by specific issuer developments, or the unavailability of additional financing.

The risk of loss due to default by the issuer may be significant for the holders of REIT Debt Securities because such securities may be unsecured and may be subordinated to other creditors of the issuer of such securities.

Downward movements in interest rates could also adversely affect the performance of REIT Debt Securities. REIT Debt Securities may have call or redemption features that would permit the issuer thereof to repurchase the securities from the holders. If a call were exercised by the issuer of REIT Debt Securities during a period of declining interest rates, it is possible that holders such REIT Debt Securities would have to replace REIT Debt Securities with lower yielding investments.

As a result of the limited liquidity of REIT Debt Securities, their prices have at times experienced significant and rapid decline when a substantial number of holders have decided to sell. In addition, when REIT Debt Securities are collateralizing a CDO, the applicable CDO security issuers may have difficulty disposing of certain REIT Debt Securities because there may be a thin trading market for such securities. Reduced secondary market liquidity may have an adverse impact on market price and the CDO security issuers' ability to dispose of particular issues when necessary to meet such CDO security issuers' liquidity needs or in response to a specific economic event such as deterioration in the creditworthiness of the issuer of such securities.

Loans and High Yield Bonds - A portion of CDO collateral may consist of corporate loans or corporate bonds. High yield debt securities generally are unsecured (and loans may be unsecured) and may be subordinated to certain other obligations of the issuer thereof. The lower ratings of high yield securities and below investment grade loans reflect a greater possibility that adverse changes in the financial condition of an issuer or in general economic conditions or both may impair the ability of the related issuer or obligor to make payments of principal or interest. Such investments may be speculative.

Issuers of CLOs may acquire interests in loans and other debt obligations and derivatives by way of sale, assignment, participation or contractual obligation. The purchaser of an assignment typically succeeds to all the rights and obligations of the assigning institution and becomes a lender under the credit agreement with respect to the loan or debt obligation; however, its rights can be more restricted than those of the assigning institution. Such loans are typically negotiated by one or more commercial banks or other financial institutions and syndicated among a group of commercial banks and financial institutions.

Corporate loans are typically at the most senior level of the capital structure, and are often secured by specific collateral, including, but not limited to, trademarks, patents, accounts receivable, inventory, equipment, buildings, real estate, franchises and common and preferred stock of the obligor and its subsidiaries. The corporate loans may be of a type generally incurred by the borrowers thereunder in connection with a highly leveraged transaction, often to finance internal growth, acquisitions, mergers, stock purchases, or for other reasons. As a result of the additional debt incurred by the borrower in the course of the transactions, the borrower's creditworthiness is often judged by rating agencies to be below investment grade. Certain of the loans included (or referenced) may be subordinated to other obligations of the borrower. In order to induce the banks and institutional investors to invest in a borrower's loan facility, and to offer a favorable interest rate, the borrower often provides the banks and institutional investors with extensive information about its business, which is not generally available to the public. Because of the provision of confidential information, the unique and customized nature of a loan agreement, and the private syndication of the loan, loans are not as easily purchased or sold as a publicly traded security and historically the trading volume in the loan market has been small relative to the high yield bond market.

Corporate loans often provide for restrictive covenants designed to limit the activities of the borrower in an effort to protect the right of lenders to receive timely payments of interest on, and repayment of principal of, the loans. Such covenants may include restrictions on dividend payments, specific mandatory minimum financial ratios, limits on total debt and other financial tests. A breach of covenant (after giving effect to any cure period) in a loan that is not waived by the lending syndicate normally is an event of acceleration that allows the syndicate to demand immediate repayment in full of the outstanding loan. Loans usually have shorter terms than more junior obligations and may require mandatory prepayments from excess cash flow, asset dispositions and offerings of debt and/or equity securities.

The majority of corporate loans bear interest based on a floating rate index, the certificate of deposit rate, a prime or base rate (each as defined in the applicable loan agreement) or other index, which may reset daily (as most prime or base rate indices do) or offer the borrower a choice of one, two, three, six, nine or twelve month interest and rate reset periods. The purchaser of a loan may receive certain syndication or participation fees in connection with its acquisition. Other fees payable in respect of a loan, which are separate from interest payments on such loan, may include facility, commitment, amendment and

prepayment fees.

Purchasers of corporate loans are predominantly investment and commercial banks that have applied their experience in high yield securities to the commercial and industrial loan market, acting as both principal and broker. The range of investors for loans has broadened to include money managers, insurance companies, arbitrageurs, bankruptcy investors and mutual funds seeking increased potential total returns and portfolio managers of trusts or special purpose companies issuing collateralized bond and loan obligations. There can be no assurance, however, that future levels of supply and demand in loan trading will provide the degree of liquidity that currently exists in the high yield debt securities market.

In purchasing participations, a buyer will usually have a contractual relationship only with the selling institution, and not the borrower. The holder generally will have neither the right directly to enforce compliance by the borrower with the terms of the loan agreement, nor any rights of set-off against the borrower, nor have the right to object to certain changes to the loan agreement agreed to by the selling institution. A loan participation may not directly benefit from the collateral supporting the related loan and may be subject to any rights of set-off the borrower has against the selling institution. In addition, in the event of the insolvency of the selling institution, under the laws of the United States of America and the states thereof, the holder may be treated as a general creditor of such selling institution, and may not have any exclusive or senior claim with respect to the selling institution's interest in, or the collateral with respect to, the loan. Consequently, the loan participations may be subject to the credit risk of the selling institution as well as of the borrower.

Trust-Preferred Securities - A portion of CDO Securities may be backed by "Trust-Preferred Securities". Trust-Preferred Securities are generally issued by special purpose trust subsidiaries of financial institutions. The trust subsidiary uses the proceeds of the sale of its Trust-Preferred Securities to purchase deferrable debentures (the "Corresponding Debentures") or other subordinated debt of its parent financial institution or holding company (the "Corresponding Debenture Issuer"). A trust's only source of cash to make payments on its Trust-Preferred Securities will be the interest payments it receives on the Corresponding Debentures. The cash flow characteristics of the Trust-Preferred Securities have maturities and coupons that mirror the Corresponding Debentures of the Corresponding Debenture Issuer.

The Trust-Preferred Securities issued by each trust will generally be redeemed when the Corresponding Debentures issued by its Corresponding Debenture Issuer are paid at maturity, or upon earlier redemption of the Corresponding Debentures. The Trust-Preferred Securities may have varying coupon rates, distribution or payment dates and accrual periods, call prices and dates, maturity dates and other terms from one another.

Payments under the Corresponding Debentures, and in turn under the Trust-Preferred Securities and CDO Securities that they underlie, are highly dependent upon payments received from the relevant Corresponding Debenture Issuer and its subsidiaries. As such, the ability of CDO Security issuers to make payments to its security holders may be adversely affected by the performance of any such CDO collateral owned by CDO Security issuers and earnings of and defaults by obligors of the underlying Trust-Preferred Securities and Corresponding Debenture. Furthermore, adverse developments with respect to the financial industry in general may adversely affect the ability of a Corresponding Debenture Issuer to make payments under the Corresponding Debentures, and, due to the resulting negative impact on cash flow under the

Trust-Preferred Securities and CDO Securities they underlie, the ability of the CDO Security issuers to make payments may be adversely affected.

The only source of cash for a trust to make payments on its Trust-Preferred Securities will be payments it receives from its Corresponding Debenture Issuer on the Corresponding Debentures. The obligations of each Corresponding Debenture Issuer under the guarantee it provides in respect of the Trust-Preferred Securities and its Corresponding Debentures will be unsecured, subordinate and junior in right of payment to all present and future senior indebtedness of such Corresponding Debenture Issuer. No payment of principal of or premium, if any, or interest on any Corresponding Debenture may be made if (i) any payment due in respect of senior indebtedness of the issuing Corresponding Debenture Issuer is not paid when due and any applicable grace period with respect to such default has ended with such default not having been cured or waived or ceasing to exist or (ii) the maturity of any senior indebtedness of the issuing Corresponding Debenture Issuer has been accelerated because of a default and such acceleration has not been rescinded or cancelled. In addition, Corresponding Debenture Issuers may be parties to agreements with holders of their senior indebtedness that have the practical effect of further subordinating the rights of holders of the Corresponding Debentures to such holders of their senior indebtedness under certain circumstances. Any Corresponding Debenture Issuer or any subsidiary of any Corresponding Debenture Issuer may incur additional indebtedness, secured or unsecured, including any senior indebtedness, without limitation.

The Corresponding Debentures are not insured or guaranteed by the regulatory authority of any financial institution, any governmental agency or instrumentality or any insurance guaranty fund. Because each Corresponding Debenture Issuer that issues Corresponding Debentures may be a holding company, its ability to make distributions on the Corresponding Debentures will be highly dependent upon the earnings of its subsidiaries, and its ability to receive payments from such subsidiaries in the form of dividends, fees, loans or distributions. The subsidiaries of each Corresponding Debenture Issuer are separate and distinct legal entities and have no obligation, contingent or otherwise, to pay any amounts under the Corresponding Debentures or any guarantee provided by the Corresponding Debenture Issuer in respect of the Trust-Preferred Securities, or to make any funds available therefor, whether by dividends, loans or other payments.

There are also various legal and regulatory limitations on the extent to which a Corresponding Debenture Issuer's subsidiaries may extend credit, pay dividends or otherwise supply funds to the Corresponding Debenture Issuer or its affiliates. In particular, with respect to financial institutions that are insurance companies, payments of dividends or other distributions to the Corresponding Debenture Issuer or its affiliates by the Corresponding Debenture Issuer's U.S. domiciled insurance company subsidiaries are subject to the various insurance regulatory restrictions of the states having jurisdiction over such insurance company subsidiaries. Such laws typically vary from state to state. Certain states generally require that any statutory surplus following any dividend or distribution be reasonable in relation to such subsidiary's outstanding liabilities and adequate to meet its financial needs and permit the payment of dividends only out of earned (unassigned), as opposed to contributed, statutory surplus. In addition, many states prohibit an insurance company, without prior notice to and approval of the applicable regulatory authority, to declare or pay an extraordinary dividend, which is typically defined as any dividend or distribution of cash or other property whose fair market value, together with other dividends or distributions made within the preceding 12 months, exceeds the greater of such subsidiary's statutory net gain from operations of the

preceding calendar year or 10% of statutory surplus as of the preceding December 31st, although some states use more stringent standards. For insurance regulatory purposes, the surplus of an insurance company is generally determined on the basis of Statutory Accounting Practices (“SAP”) prescribed or permitted by the state of domicile rather than U.S. generally accepted accounting principles (GAAP). SAP generally is a more conservative measure of an insurance company’s surplus.

In addition, certain agreements, loans, exchanges of assets and other transactions between an insurance company subsidiary and its affiliates, including its Corresponding Debenture Issuer, may require prior notice to or approval of the applicable regulatory authority. Such restrictions and requirements may affect the permissibility and timing of distributions to a Corresponding Debenture Issuer from its insurance company subsidiaries. Moreover, the right of a Corresponding Debenture Issuer to participate in any distribution of assets of any of its subsidiaries upon liquidation, reorganization or otherwise will be subject to the claims of the creditors and any preferred equity holders of the applicable subsidiary, except to the extent that the Corresponding Debenture Issuer is recognized as a creditor of such subsidiary. Even if the Corresponding Debenture Issuer is recognized as a creditor of its insurance company subsidiary, its claims as such will likely be subordinated to those of policyholder creditors in the context of the liquidation of the insurance company subsidiary pursuant to the applicable state insolvency laws governing such liquidation. Accordingly, the Corresponding Debenture Issuer’s Corresponding Debentures and guarantee will effectively be subordinated to all existing and future liabilities and preferred equity of the Corresponding Debenture Issuer’s insurance subsidiaries.

- A default in the payment of principal of or premium, if any, or interest on, or a deferral in interest payments on, any Corresponding Debentures will decrease the amount of cash available to the Issuers to make payments on the applicable CDO Securities.

The terms and provisions of the Trust-Preferred Securities may vary and such variations may be material. There can be no assurance that differences between the terms and provisions of some Trust-Preferred Securities in comparison to the terms and provisions of other Trust-Preferred Securities will not have an adverse effect on CDO Securities that they underlie and, consequently, on CDO Security issuers that own any such CDO collateral.

Credit Support Limitations - The amount, type and nature of insurance policies, subordination, letters of credit and other credit support, if any, with respect to certain ABS and MBS are based upon actuarial analysis. There can be no assurance that the historical data supporting such actuarial analysis will accurately reflect future experience nor any assurance that the data derived from a large pool of mortgage loans accurately predicts the delinquency, foreclosure or loss experience of any particular pool of loans.

Lower Credit Quality Securities - There are no restrictions on the credit quality of the investments to be made by Tolis for its clients. Securities in which Tolis may invest may be deemed by rating agencies to have substantial vulnerability to default in payment of interest and/or principal. Other securities may have the lowest quality ratings or may be unrated. Lower rated and unrated securities may have large uncertainties or major risk exposures to adverse conditions and are considered to be predominantly speculative. Generally, such securities offer a higher return potential than higher rated securities, but involve greater volatility of price and greater risk of loss of income and principal.

The market values of certain of these securities (such as subordinated securities) also tend to be more sensitive to changes in economic conditions than higher rated securities. Declining real estate values, in particular, will increase the risk of loss upon default, and may lead to a downgrading of the securities by rating agencies. The value of such Leveraged Loans, ABS and MBS may also be affected by changes in the market's perception of the entity issuing or guaranteeing them, or by changes in government regulations and tax policies.

In general, the ratings of nationally recognized rating organizations represent the opinions of such agencies as to the quality of securities that they rate. Such ratings may be used by Tolis as an initial basis for the selection of portfolio securities. Such ratings, however, are relative and subjective; they are not absolute standards of quality and do not evaluate the market value risk of the securities. It is also possible that a rating agency might not change its rating of a particular issue on a timely basis to reflect subsequent events.

Liquidity of Markets - At times, certain sectors of the fixed income markets (such as the Leveraged Loan, ABS and MBS markets) have in the past experienced significant falloffs in liquidity. While such events may sometimes be attributable to changes in interest rates or other factors, the cause is not always apparent. During such periods of market illiquidity, a holder of such securities may not be able to sell assets in its portfolio or may only be able to do so at unfavorable prices. Such "liquidity risk" could adversely impact the value of an investment, and may be difficult or impossible to hedge against.

Default and Recovery Rates of Loans and High Yield Securities - There are varying sources of statistical default and recovery rate data for loans and high yield securities and numerous methods for measuring default and recovery rates. The historical performance of the high yield market or the leveraged loan market is not necessarily indicative of its future performance.

Hedging Transactions - Tolis may utilize a wide variety of financial instruments, including, without limitation: United States Treasury securities and agency debentures; swaps, caps, floors and other derivatives on interest rates; futures and forward contracts; MBS pass-throughs and MBS derivatives; derivatives, such as credit default swaps, on the credit of one or more issuers, including without limitation those referencing a single corporate issuer, single ABS or MBS securities and indices of such instruments; equities; and options and other derivatives on any of the foregoing, for investment purposes and for risk management purposes.

Tolis may pursue various hedging strategies to seek to reduce the potential exposure to losses from default or from adverse changes in interest rates and other factors. Some hedges are designed to directly address cash flow mismatches between assets and liabilities (for example, an interest rate cap purchased to hedge a capped floating rate asset financed with short-term borrowings), while others are designed merely to maintain a stable market value of the overall portfolio (an interest rate swap used to hedge an interest only security with prepayment risk). Hedging against a decline in the values of the portfolio's positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline.

Tolis' hedging activity will vary in scope based on the level and volatility of interest rates, the type of assets held and other changing market conditions. Also, it may not always be possible to dispose of or

close out a hedging position without the consent of the hedging counterparty, and Tolis may not be able to enter into an offsetting contract in order to cover the risk. A liquid secondary market may not exist for hedging instruments purchased or sold, and Tolis may be required to maintain a position until exercise or expiration, which could result in losses.

The success of any hedging strategy will be subject to Tolis' ability to correctly assess the degree of correlation between the performance of the instruments used in the hedging strategy and the performance of the investments in the portfolio being hedged. Any imperfect correlation may prevent Tolis from achieving the intended hedge and expose clients to risk of loss. Since the characteristics of many assets change as markets change or time passes, the success of any hedging strategy will also be subject to Tolis' ability to continually recalculate, readjust, and execute hedges in an efficient and timely manner. Hedging transactions generally will limit the opportunity for gain if the values of the portfolio positions should increase. While Tolis may enter into hedging transactions to seek to reduce risk, such transactions may result in a poorer overall performance than if it had not engaged in any such hedging transactions. For a variety of reasons, Tolis may not seek to hedge certain portfolio holdings, or may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Moreover, the portfolio will always be exposed to certain risks that cannot be hedged, such as certain types of credit risk (including, without limitation, those relating to particular investments and counterparties), liquidity risk and "widening" risk (as described above).

Short Sales - Short sales, which involve a sale of a security that the investor does not own in the hope of purchasing the same security (or a security exchangeable therefore) at a later date at a lower price, can result in profits when the prices of the securities sold short decline, and losses, which are theoretically unlimited, when such prices increase.

Options - Tolis may invest in, or write, options. The purchaser of a put or call option runs the risk of losing the entire investment in a relatively short period of time if an option expires unexercised. The uncovered writer of a call option is subject to a risk of loss should the price of the underlying security increase, and the uncovered writer of a put option is subject to a risk of loss should the price of the underlying security decrease.

Credit Default Swaps - Tolis may invest in credit default swaps. Credit default swaps can be used to hedge a portion of the default risk on a single corporate or structured credit bond or a portfolio of bonds. In addition, credit default swaps can be used to implement the view of Tolis that a particular credit, or group of credits, will experience credit improvement. In the case of expected credit improvement, Tolis may "write" credit default protection in which they receive spread income. Tolis may also "purchase" credit default protection even in the case in which it does not own the referenced instrument if, in the judgment of Tolis, there is a high likelihood of credit deterioration.

Credit default swaps referencing corporate obligors are priced incorporating many variables including the pricing and volatility of the common stock and debt of the company, and potential loss realized on the debt upon default, among other factors. Credit default swaps referencing structured credit obligors are priced also based upon a number of different parameters which may include collateral default and recovery rates, interest rates, prepayment rates, or interpretations of priority of payments and specific transaction covenants. Swap transactions referencing structured credit obligations may incorporate "pay-

as-you-go” features (“PAUG”) which attempt to mimic the complex payment mechanics of structured finance securities. The timing and amount of principal and interest payments are variable, even after a credit event. PAUG provisions provide for a two way flow of payments between counterparties, as opposed to a single fixed amount for a recovery payment after a default.

There are many factors upon which market participants may have divergent views with respect to credit default swaps. If Tolis has a positive view of a company’s credit outlook or a structured credit instrument’s prospects, it may enter into credit default swap transactions in which it assumes the risk of default of an issuer. It may also enter into an opposite transaction, even if the credit outlook is positive, if it believes that participants in the marketplace have incorrectly valued the components determining the value of a swap.

Total Return Swaps - Total return swaps are another form of derivative that Tolis may utilize to achieve its investment objective. A total rate of return swap allows the total return receiver to receive the change in market value of an asset (whether a security, interest rate, form of debt, currency or other asset) from the total return payer in return for paying a floating or fixed interest rate on a predetermined amount. The total return payer is synthetically short and the total return receiver is synthetically long. This may create a highly leveraged exposure to such underlying asset.

Interest Rate Swaps and Asset Swaps - Tolis may also enter into interest rate swaps and asset swaps. An interest rate swap is a derivative where the parties exchange interest payments on a specific principal amount per payment period, typically exchanging a fixed amount for a floating amount (an amount equal to a variable interest rate (such as LIBOR) multiplied by the principal amount). In the event that a client enters into an interest rate swap and is paying a fixed amount, the client risks that the variable interest rate will decrease and therefore it is paying more than it is receiving. Alternatively, in the event that the client is paying a floating amount, it risks that the variable interest rate will increase and therefore it is paying more than it is receiving. An asset swap has similar risks. An asset swap is an exchange of two assets, such as one currency for another or an interest rate for another. In such a derivative, the investor bears the risk that the asset or interest rate that it is paying will be greater than the asset or interest rate that it is receiving.

Item 9: Disciplinary Information

Tolis, and its employees, have not been involved in any legal or disciplinary events that would be considered material to a client's or prospective client's evaluation of its business or the integrity of its management.

Item 10: Other Financial Industry Activities and Affiliations

None of Tolis or its management persons are registered as a broker-dealer or a registered representative of a broker-dealer. In addition, Tolis and its management persons are not affiliated with any broker-dealer or bank.

None of Tolis or any of its management persons are registered as a registered futures commission merchant, commodity pool operator or commodity trading advisor.

Tolis and its related persons may not spend substantially all of their business time on one or more of its clients.

Representatives of Tolis and its affiliates may serve as members of the board of directors or creditors committee of a portfolio company, have other ongoing relationships or be given access for other reasons to confidential information relating to companies in which a client invests. In such cases, Tolis or its affiliates may be required by its fiduciary obligations on behalf of such entities to take actions that are not in the best interests of such client. If Tolis or its affiliates receive confidential information on a portfolio company, the clients may, under certain circumstances, be prohibited for a period of time from engaging in transactions with respect to the debt or securities of such a portfolio company. Employees of Tolis may also from time to time receive compensation directly from a portfolio company for such service. Receipt of such compensation may create a conflict of interest between a board member's personal interests, the interests of the clients, and the interests of the portfolio company and its other shareholders. While Tolis has compliance policies and procedures designed to monitor conflicts of interests relating to the outside activities of employees of Tolis, such as serving as a member of the board of directors of a portfolio company, such policies and procedures may not be effective.

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

Tolis has established a Code of Ethics that sets forth standards of ethical conduct for itself and its employees. This Code of Ethics is predicated on the principle that Tolis owes a fiduciary duty to its clients. Accordingly, employees must avoid activities, interests and relationships that run contrary (or appear to run contrary) to the best interests of Tolis' clients. At all times, employees of Tolis must:

- **Place client interests ahead of Tolis'** - As a fiduciary, Tolis will serve in its clients' best interests. In other words, employees may not benefit at the expense of advisory clients. This concept is particularly relevant when employees are making personal investments in securities traded by advisory clients.
- **Engage in personal investing that is in full compliance with Tolis' Code of Ethics** - Employees must review and abide by Tolis' Personal Account Dealing Procedures.
- **Avoid taking advantage of position of employment** - Employees must not accept investment opportunities, gifts or other gratuities from individuals seeking to conduct business with Tolis, or on behalf of an advisory client, unless in compliance with Tolis' gift policy, which is outlined below.
- **Maintain full compliance with applicable securities laws** - Employees must abide by all applicable securities law standards.

Guiding Principles & Standards of Conduct

All employees of Tolis will act with competence, diligence and integrity and in an ethical manner when dealing with clients, the public, prospective clients, third-party service providers and fellow employees. The following set of principles frames the professional and ethical conduct that Tolis expects from its employees:

- to act with integrity, competence, diligence, respect, and in an ethical manner with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets;
- to place the integrity of the investment profession, the interests of clients, and the interests of Tolis above one's own personal interests;
- to adhere to the fundamental standard that employees should not take inappropriate advantage of their position;
- to avoid any actual or potential conflict of interest;

- to conduct all personal securities transactions in a manner consistent with Tolis' Personal Account Dealing Procedures;
- to use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities;
- to practice and encourage others to practice in a professional and ethical manner that will reflect favorably on the employee and Tolis;
- to promote the integrity of, and uphold the rules governing, capital markets;
- to maintain and improve one's professional competence and strive to maintain and improve the competence of other employees; and
- to comply with applicable provisions of the United States securities laws and all other applicable securities laws.

Personal Account Dealing Procedures

Tolis' employees are permitted to invest on their own behalf solely in accordance with Tolis' Personal Securities Transaction Policy, as set forth herein. The purpose of this Personal Securities Transaction Policy is to ensure that the employees of Tolis and certain other individuals and organizations do not actively trade in the securities of entities (i) that Tolis is analyzing and/or considering for potential investment, (ii) in which one or more client holds a position or (iii) in which Tolis is restricted.

Insider Trading Policy

Investment advisers may have access to material information that has not been publicly disseminated. United States securities laws prohibit any purchase or sale of securities on the basis of material non-public information which was improperly obtained, or where it was obtained under circumstances contemplating that it would not be used for personal gain, and in certain other circumstances. In addition, "tipping" of others about such information is prohibited. Not only are the persons covered by these restrictions considered "insiders" of publicly traded companies, but so are any other persons who, under certain circumstances, learn of material non-public information about a company, such as attorneys, investment advisers, accountants, consultants or bank lending officers.

Tolis has adopted the general policy that an employee may neither trade in securities of any entity about which the employee possesses material, non-public information, nor "tip" others about such information. The policies and procedures summarized below are intended to implement this general policy.

Given the severe penalties imposed on individuals and firms engaging in insider trading, employees:

- shall not trade the securities of any entity in which they are deemed to possess material, non-public information about the entity;

- shall not engage in securities transactions of any entity, except in accordance with Tolis' Personal Account Dealing Procedures and applicable securities laws;
- shall submit the Initial and Annual Holdings Reporting Form in accordance with the Personal Account Dealing Procedures, and comply with any other requirements Tolis may impose from time to time in respect of the disclosure of personal security holdings (including, for example, instructing their broker(s) to send their quarterly security statements directly to Tolis);
- shall not discuss any potentially material, non-public information with colleagues, except as specifically required by their position;
- shall immediately report the potential receipt of non-public information to the Chief Compliance Officer or, in his absence, one of the Co-Chief Investment Officers; and
- shall not proceed with any research, trading, etc. until the Chief Compliance Officer informs the employee of the appropriate course of action.

Loans

No employee may borrow funds from or become indebted to any person, business or company having business dealings or a relationship with Tolis, except with respect to customary personal loans (e.g., home mortgage loans, automobile loans, lines of credit, etc.), unless the arrangement is disclosed in writing and receives prior written approval from the Chief Compliance Officer. No employee may use Tolis' name, position in a particular market or goodwill to receive any benefit on loan transactions without the prior express written consent of the Chief Compliance Officer.

Dealings with Government and Industry Regulators

Tolis' policy forbids payments of any kind by Tolis, its employees or any agent or other intermediary to any government official, self-regulatory official or other similar person or entity, within the United States or abroad, for the purpose of obtaining or retaining business, or for the purpose of influencing favorable consideration of any application for a business activity or other matter. This policy covers all types of payments, even to minor government officials and industry regulators, regardless of whether the payment would be considered legal under the circumstances.

Gifts

Employees may not accept limited investment opportunities, lavish gifts or other extravagant gratuities from individuals seeking to conduct business with Tolis, or on behalf of an advisory client, except in accordance with the following policies and procedures. It is a violation of an employee's duty of loyalty to Tolis to violate any of the following policies and procedures:

- Employees are prohibited from giving or receiving, directly or indirectly, to or from any principal, proprietor, employee, agent or representative of any entity with which the Tolis is conducting business any in-kind gifts of any type in excess of \$250 except dinners, where such gift is in relation to business between such entity and Tolis, without the prior written approval of the Chief Compliance Officer, which may be withheld in his reasonable discretion. Any gifts in excess of this amount will be logged by the Chief Compliance Officer.
- Employees may not rebate, directly or indirectly, to any person, firm, corporation or association, cash compensation of any nature as a bonus, commission, fee, gratuity or other consideration in connection with any transaction on behalf of Tolis or a client.
- Employees may not accept, directly or indirectly, from any person, firm, corporation or association, other than Tolis, cash compensation of any nature as a bonus, commission, fee, gratuity or other consideration in connection with any transaction on behalf of Tolis or a client.

Item 12: Brokerage Practices

Subject to the investment objectives, policies and restrictions of each Fund and Separate Account as set forth in such Fund's governing documents or the account management agreement of such Separate Account, Tolis typically has discretionary authority to determine the type, amount, and price of securities and investments to be bought and sold on behalf of each client, including the selection of, and commissions paid to, brokers.

Best Execution

In placing orders to purchase and sell securities for clients, Tolis seeks to obtain best execution by considering a number of factors in selecting appropriate broker-dealers, including execution capability, availability of securities in inventory, commission rates, financial responsibility, the value of research provided and responsiveness. Tolis seeks to fairly evaluate the overall quality and costs of a broker-dealer's execution services, including factors other than prices, commissions and other expenses paid in connection with account transactions. The factors considered in selecting and approving brokers-dealers that may be used to execute trades for client accounts include, but are not limited to:

- Quality of execution - accurate and timely execution, clearance and error/dispute resolution;
- Availability of securities in inventory, in particular for securities traded on a principal basis in the OTC markets such as fixed income and derivatives markets;
- Reputation, financial strength and stability;
- Block trading and block positioning capabilities;
- Willingness to execute difficult transactions;
- Willingness and ability to commit capital;
- Access to underwritten offerings and secondary markets;
- Ongoing reliability;
- Overall costs of a trade (i.e., net price paid or received) including commissions, mark- ups, mark-downs or spreads in the context of Tolis' knowledge of negotiated commission rates currently available and other current transaction costs;
- Nature of the security and the available market makers;
- Desired timing of the transaction and size of trade;

- Confidentiality of trading activity;
- Market intelligence regarding trading activity;
- Willingness to execute related or unrelated difficult transactions in the future;
- the availability of stocks to borrow for short trades.

Research and Other Soft Dollar Benefits

Tolis may take into account research and other services provided to Tolis by brokers. Tolis does not necessarily solicit competitive bids and does not have an obligation to seek the lowest available commission cost. Tolis may cause a higher commission to be paid to a broker or dealer that furnishes research, services or equipment than might be charged by another broker or dealer for effecting the same transaction, provided that Tolis determines in good faith that the amount of commissions charged is reasonable in relation to the value of the brokerage and research or investment management-related services and equipment provided by such broker or dealer.

Research services provided to Tolis by brokers may include written information and analyzes concerning specific securities, companies or sectors (whether produced by the broker or a third party); market, financial and economic studies and forecasts (whether produced by the broker or a third party); statistics and pricing services; discussions with research personnel; databases; and other news, technical and telecommunications services utilized by Tolis in the investment management and execution process, accounting fees and legal fees. Tolis does not expect to receive any benefits outside the safe harbor under Section 28(e) of the Securities Exchange Act of 1934, as amended, for the use of commissions or “soft dollars” to obtain “research and execution” services. Research services provided by brokers may be used for the benefit of all clients of Tolis.

Tolis’ use of client brokerage commissions to obtain research services is a benefit to Tolis because Tolis does not have to produce or pay for such research services. This may result in an incentive for Tolis to select or recommend a broker-dealer based, in part, on the interest of Tolis in receiving such research services, rather than exclusively on the interest of Tolis’ clients in receiving most favorable execution.

Tolis and its affiliates may have other business arrangements with brokers and dealers used to execute transactions for clients. Brokerage firms and their affiliates and representatives may invest in funds managed by Tolis, and may provide financing or other services to Tolis or other accounts managed by Tolis. Brokerage firms and their employees may offer gifts to employees of Tolis, and may invite employees of Tolis to entertainment and social events. It is Tolis’ policy that factors such as gifts and entertainment that do not benefit client accounts should not be considered when selecting brokers and counterparties to execute transactions for clients.

Brokerage for Client Referrals

Subject to Tolis’ obligation to seek best execution of all transactions for its clients, Tolis may consider referrals of investors in determining its selection of broker-dealers. Tolis may have an incentive to select or

recommend a broker-dealer based on its interest in receiving investor referrals, rather than on its clients' interest in receiving the most favorable execution.

Directed Brokerage

Tolis does not recommend, request or require clients to direct it to execute transactions through a specified broker-dealer.

Trade Aggregation

Tolis has established allocation and aggregation procedures for the allocation of portfolio investment transactions among its client accounts. The allocation and aggregation procedures are designed to ensure that each account is treated fairly and that transactions are allocated in a manner that is fair and equitable to each client relative to the other clients, taking into account all relevant facts and circumstances. If all orders placed for client accounts cannot be fully executed under prevailing market conditions, then the securities traded may be allocated among client accounts on a pro rata basis or in some other equitable manner, taking into account the size of the order placed for each account and any other relevant factors. The aggregation of orders may not always be to the benefit of a client account with regard to the price or quantity executed.

Item 13: Review of Accounts

The Chief Compliance Officer has the primary responsibility of reviewing and monitoring all investments made for Tolis' clients. Tolis conducts such review on an ongoing basis. Matters generally reviewed include specific securities held, adherence to investment guidelines and the performance of each client account.

Significant changes in market volatility, the value of the client's portfolio or the performance of investment positions are examples of various factors that may prompt additional review of client accounts as deemed necessary by Tolis' Investment Committee or Mr. Puliafico. Salvatore Puliafico can be reached at +1 646.863.6120.

Reports Sent to Fund Investors

Each investor in a Fund receives: (i) monthly, unaudited statements, (ii) an monthly report on the affairs of such Fund, (iii) an annual financial report of the Fund audited by a nationally or internationally recognized accounting firm and (iv) with respect to investors in the domestic feeder fund, tax information reported on IRS Form K-1 annually.

Separate Account clients typically receive daily reporting with respect to the portfolio investments of such Separate Account.

Investors in the Funds should refer to the governing documents of each Fund for further information on the reports provided by a particular Fund to its investors. Each Separate Account client should refer to the account management agreement governing the relationship between Tolis and such Separate Account for further information on reporting.

Item 14: Client Referrals and Other Compensation

Tolis or its affiliates may enter into arrangements to pay third parties who introduce clients to Tolis or its affiliates a portion of the advisory fees received by Tolis or its affiliates from such clients. Such arrangements will be disclosed to Tolis' clients in accordance with, and otherwise comply with, Rule 206(4)-3 under the Advisers Act to the extent applicable.

Tolis and its affiliates may enter into arrangements to pay to placement agents or third parties introducing investors to a Fund a portion of the advisory fees received by Tolis or its affiliates from such Fund.

Tolis may also consider referrals of clients or investors to the Funds in determining its selection of broker-dealers for securities transactions.

Item 15: Custody

Tolis will not have physical custody of any client assets, all of which are held by one or more qualified custodians, except for certain privately offered securities that are not required to be maintained with a qualified custodian.

Tolis may be deemed to have custody of the assets of the Funds as a result of its authority over the Funds. It is Tolis' policy to cause each Fund with assets over which Tolis is deemed to have "custody" to be audited annually and distribute audited financial statements to investors no later than 120 days after the end of each fiscal year.

Separate Account clients should receive at least monthly statements from the broker dealer, bank or other qualified custodian that holds and maintains the client's investment assets. Tolis urges its clients to carefully review such statements and compare such official custodial records to the account statements that Tolis may provide to its clients.

The Funds' statements prepared by Tolis' Administrator may vary from custodial statements based on accounting procedures, reporting dates, or valuation methodologies of certain securities.

Item 16: Investment Discretion

Tolis has discretionary authority to make investment decisions for the Funds in accordance with, and in furtherance of, the applicable investment strategy as set forth in the applicable governing documents of each Fund. Investors in the Funds do not have the ability to impose limitations on the discretionary authority of Tolis.

Tolis may manage client accounts for which it may not have ongoing discretionary authority to execute transactions without the consent of the client. Securities transactions for such clients may be entered into on a stand-alone basis and not bundled with investments made by clients that have given Tolis full discretion to effect securities transactions. Accordingly, such “non-discretionary” clients should be aware that Tolis may place non-discretionary client trades prior to or subsequent to discretionary client trades, and therefore a disparity may exist in the price at which securities are sold for discretionary and non-discretionary accounts. In addition, a disparity may exist between the commissions charged to non-discretionary clients and the commissions charged to clients that have given Tolis full discretion. Therefore, non-discretionary clients should be aware that Tolis may not be able to maximize the transaction price and/or obtain volume discounts for non-discretionary clients.

Item 17: Voting Client Securities

As a fiduciary with proxy voting authority, Tolis has a duty to monitor corporate events and to vote proxies, as well as a duty to cast votes in the best interest of clients and not subrogate client interests to its own interests. Rule 206(4)-6 under the Advisers Act (the “Proxy Voting Rule”) places specific requirements on registered investment advisers with proxy voting authority.

In light of Tolis’ emphasis on fixed income and structured credit strategies, it is likely that proxy voting will be rare, and accordingly Tolis’ Investment Committee, in consultation with the Chief Compliance Officer, must pre-approve all proxy votes. Tolis’ policies and procedures are reasonably designed to ensure that it votes proxies in the best interest of its clients and addresses how it will resolve any conflict of interest that may arise when voting proxies.

However, should the need for Tolis to vote a proxy on behalf of any of its clients ever arise, Tolis will follow the procedure outlined below.

Any proxies received will be provided to the Investment Committee which, prior to voting such proxy, will determine if there are any conflicts of interest related to the proxy in question. If a potential conflict is identified, the Investment Committee will inform the Chief Compliance Officer of the details of such proxy and the perceived conflict of interest. The Investment Committee and the Chief Compliance Officer together will make a determination as to whether the conflict is material. If no material conflict is identified, Tolis will vote the proxy in question in accordance with the best interest of the relevant Fund or Separate Account.

If a material conflict is identified by the Investment Committee and Chief Compliance Officer, Tolis will generally seek to mitigate the conflict by either appointing an independent third party to vote such proxies or disclosing the conflict to the affected clients and giving such clients the opportunity to vote the proxies in question themselves.

Tolis will deliver any completed proxies in accordance with instructions related to such proxy. Tolis will keep a record of its proxy voting policies and procedures, proxy statements received, votes cast, communications received and internal documents created that were material to voting decisions and Investor requests for proxy voting records and Tolis’ response.

Clients may obtain information from Tolis about how it voted such Client’s securities and may obtain a copy of its proxy voting policies and procedures upon request by contacting Tolis’ Chief Compliance Officer, Salvatore Puliafico at the address shown on the cover page of this Brochure.

Item 18: Financial Information

Tolis is not aware of any financial condition that is reasonably likely to impair its ability to meet contractual commitments to its clients, and has not been the subject of a bankruptcy petition at any time.