



Form ADV Part 2A Brochure

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This brochure provides information about the qualifications and business practices of Lone Star North America Acquisitions, L.P. (“LSNAALP”) and its relying advisers, including Lone Star Global Acquisitions, Ltd. (“LSGA”). Together, LSNAALP, its relying advisers and its participating affiliates (listed in Item 10) are referred to herein as “Lone Star”. If you have any questions about the contents of this brochure, please contact us at 214-754-8300. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority.

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



## **Item 2: Material Changes**

This amendment contains material changes from Lone Star's other-than-annual updating amendment dated March 29, 2018. This amendment reflects updated fee information in Item 5.

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## **Item 4: Advisory Business**

### **Lone Star**

Founded in 1995, Lone Star is a global private equity firm with Funds that invests in real estate, equity, credit and other financial assets. Lone Star provides investment advisory and related services to a family of closed-end private funds (the “Funds”) from offices in North America, Europe, Asia, and Latin America. A complete list of Lone Star relying advisers and participating affiliates is provided in Item 10.

### **The Funds**

The Funds invest in a broad range of financial and other investment assets in various U.S. and non-U.S. jurisdictions, subject to the specific objectives and restrictions in each Fund’s offering documents. These assets include, but are not limited to:

- Commercial and single family residential real estate-secured debt, corporate debt and consumer debt (including newly or recently issued loans as well as more seasoned assets);
- Direct and indirect equity investments in real estate and real estate-related assets;
- Control investments in financially oriented and other operating companies; and
- Securitized products such as residential mortgage-backed securities (“RMBS”), collateralized debt obligations (“CDOs”) (the underlying assets of which generally consist of RMBS), commercial mortgage-backed securities (“CMBS”), and other asset-backed securities (“ABS”).

A Fund may invest in assets directly or indirectly through special purpose entities formed to hold the Fund’s investments (each such entity is referred to as a special purpose vehicle or “SPV”).

Prior to 2007, the Funds made all of their investments in a single fund family. In 2007, beginning with Lone Star Fund VI and Lone Star Real Estate Fund, Lone Star decided to utilize separate Funds for commercial real estate-related investments (generally known as its “Real Estate Funds”) and for all other investment classes, including non-commercial real estate loans and securities (single-family residential, consumer, and corporate) and financial and other operating companies (generally known as its “Opportunity Funds”). In 2014, Lone Star also organized a Fund focused on newly originated performing U.S. single family residential mortgage loans and related investments.

### **Investment Process**

LSGA maintains an investment committee for each currently investing Fund that is responsible for evaluating potential investments for the Fund. Each investment committee typically includes the Chairman of LSGA, the President of LSGA, the principals of Lone Star who direct operations of Lone Star in each geographic region (each a “Regional President”), and the General Counsel of Lone Star (as a non-voting member). If an investment is approved by the investment committee, it is presented to the general partner of the applicable Fund for final approval. The general partners of the Funds (“General Partners”) are related persons of Lone Star. The investment committee and investment approval process for each Fund is provided in its offering documents.

Hudson Advisors L.P. (“HAL”), a related person of Lone Star and an SEC-registered investment adviser, provides investment advisory and related services to the Funds. HAL, Hudson Americas L.P. (“HAM”), and HAM’s relying advisers and participating affiliates (collectively, “Hudson”) typically provide due diligence and analysis services with respect to potential Fund investments to support evaluation and execution of such



investments by Lone Star. After an investment is acquired, Hudson is engaged to provide asset management services. Lone Star is not involved in the day-to-day asset management of Fund investments, but rather provides strategic oversight and advice with respect to the management and ultimate resolution of these assets. Hudson also provides various ancillary services to the Funds and their investments, including hedging, accounting, administration and periodic reporting, legal, compliance, tax, audit, cash management, risk management advice, information technology development and other similar and related services. Further information regarding Hudson and its services may be found in Item 10 and in the Form ADV Part 2 brochure for Hudson.

### **Ownership**

LSGA, a Bermuda exempted limited company, was formed in 1998. The common shares of LSGA are wholly owned by LSGA Holdings, Ltd., a Bermuda exempted limited company, which is wholly owned by Mr. John Grayken. LSGA directly or indirectly owns 100% of the filing adviser LSNAALP and each of the relying advisers and participating affiliates listed in Item 10 (other than LSGA Holdings, Ltd.).

### **Assets Under Management**

As of December 31, 2017, Lone Star provided investment supervisory services with respect to approximately \$37,989,800,000 in assets and unfunded commitments of the Funds, calculated in accordance with the methodology prescribed by the SEC for calculating Regulatory Assets Under Management.

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

### **Management Fees**

The Funds pay a management fee to LSGA for its advisory services. Such management fees are generally payable monthly in arrears during the investment period of a Fund, and quarterly in arrears thereafter. The management fee is typically based on total commitments less distributions of capital prior to the close of the investment period, and upon the termination of the investment period, on outstanding capital contributions by the Funds' limited partners. Because management fees are based on outstanding capital contributions after the termination of the investment period, the Funds and their limited partners continue to pay a management fee with respect to each investment that has not returned all of its capital or been completely written down. Accordingly, a lower aggregate management fee will likely be paid with respect to an investment that quickly returns capital than for an investment of similar size that does not return capital as quickly.

Incentive allocations received by the General Partners are discussed under Item 6.

The specific terms of the fee arrangements for each Fund are detailed in its offering documents.

### **Investor Relations Services**

At the beginning of 2018, several employees of Lone Star that provided investor relations services to the Funds were transferred to Hudson. These employees continue to provide the same services to the Funds that they provided while at Lone Star. Lone Star will continue to cover the cost of such services provided with respect to the Funds whose final closings occurred prior to 2018, without any portion of such costs being charged to the applicable Funds.

### **Hudson**

Hudson provides asset management services to the Funds and the SPVs for a fee that is capped, for each type of asset, at a specific percentage of the value of the assets under management over the life of the Fund. In addition, Hudson provides due diligence and analysis and ancillary services for a fee based on the actual cost



incurred to provide those services plus a specified margin. Hudson's fees are billed to the applicable Fund and/or SPV.

The specific terms of the fee arrangements with Hudson for each Fund are detailed in each Fund's offering documents.

In determining applicable billing rates, Hudson incorporates the overhead cost of the resources deployed, including, but not limited to, the costs of employee compensation and benefits, office leases, information technology, Hudson regulatory compliance, human resources, and other Hudson operations supporting the services provided. Hudson billing rates do not include costs of the General Partners, Lone Star, or the Funds.

### **Expenses**

In addition to the fees discussed above, the Funds are typically required to cover the expenses of their operations. Common types of expenses paid by the Funds are discussed below. To the extent that such expenses are initially incurred by Lone Star or Hudson rather than paid by the Funds or SPVs directly, the Funds will reimburse Lone Star or Hudson (as applicable) for such expenses.

Each Fund generally bears the cost of legal, travel, and other out-of-pocket organizational and syndication expenses incurred in connection with its formation and closing. The obligation of the Fund with respect to such organizational and syndication expenses will be limited to a dollar amount as set forth in the Fund's offering documents; any costs in excess of this amount will be payable by the Fund and such amounts in excess will offset management fees payable to LSGA.

Each Fund also generally bears all expenses related to its investment operations, including broker's commissions, clearance charges, due diligence expenses (related to consummated or unconsummated investments), loan servicing fees, travel expenses, taxes, other expenses incident to the purchase, maintenance and sale of investments by such Fund, charges incurred in connection with the custody of investments, outside legal and accounting fees, insurance and litigation expenses, and any taxes, fees, or other governmental charges levied against the Fund. Item 12 discusses Lone Star's practices for choosing brokers and certain other counterparties.

Expenses are generally shared on a pro rata basis by commitments between Funds under a side-by-side agreement (see Item 11 for more information on these arrangements). See Item 11 for further discussion regarding allocation of expenses.

### ***Specialty Management Firms***

In the course of making investments, certain of the Funds have acquired or created certain specialty management firms to service various assets requiring specific management expertise. Such firms are sometimes engaged to provide services to other Funds. The fees paid by the Funds receiving services under such arrangements ultimately benefit both the specialty management firms and the Funds that own them. The conflicts of interest involved with such arrangements are discussed further in Item 11. Neither Lone Star nor Hudson has an ownership interest in such firms or shares in the fees they receive.

As an example, Caliber Home Loans, Inc. ("CHL") is a full service mortgage company and special servicer jointly owned by certain of the Funds. CHL provides a full complement of services including managing collection, modification and reporting activities for U.S. residential whole loan portfolios and mortgage servicing rights owned by certain of the Funds. Certain employees of Lone Star and Hudson comprise a majority of the board of directors of CHL. The parameters of fee arrangements between CHL and the Funds other than the Funds that own it are either specified in the limited partnership agreement of the applicable Fund or approved by the Advisory Committees (defined below in Item 11) of the applicable Funds. CHL's fees for servicing are generally based on a percentage of the unpaid principal balance of the loans serviced.



CHL may also receive the types of incentive fees customarily retained by residential loan servicers for loss mitigation activities, based on a percentage of the loan balance. For any ancillary services performed by CHL (such as accounting and transaction management services), CHL's fees are based on the actual cost incurred plus a specified margin.

### **Co-Investors**

Certain employees, officers, directors, executives, members and contractors of Lone Star, Hudson, and their affiliates ("Key Employees") are given the opportunity to invest on a side-by-side basis with the Funds through employee investment vehicles (each, an "Employee Investment Vehicle"). Employee Investment Vehicles do not pay any fees to Lone Star or any promote allocations. Employee Investment Vehicles do not pay any fees directly to Hudson, but receive distributions from the underlying investments net of fees paid to Hudson, transaction costs, and other expenses allocated to the investment. The Employee Investment Vehicles also bear a pro rata portion of the unconsummated transaction costs incurred by the corresponding Funds.

The General Partners may also establish other co-investment vehicles through which investors in the Funds may participate in certain specific co-investment opportunities (each a "Co-Investment Vehicle"). Co-Investment Vehicles generally pay a promote allocation to the applicable General Partner but do not pay a management fee to Lone Star. The fee arrangements of Co-Investment Vehicles are not required to align with the arrangements of the corresponding Funds. Co-Investment Vehicles typically bear all expenses related to their formation and operation, and receive distributions from the underlying investments net of fees paid to Hudson, transaction costs, and other expenses allocated to the investment. Co-Investment Vehicles generally do not bear any share of unconsummated transaction costs for other investments pursued by the Funds.

In addition to Employee Investment Vehicles and Co-Investment Vehicles, the General Partners may offer co-investment opportunities to certain other parties. Such co-investors generally do not pay a management fee to Lone Star or a promote allocation to the applicable General Partner; they typically receive distributions from the underlying investments net of fees paid to Hudson, transaction costs, and other expenses allocated to the investment. They generally do not bear any share of unconsummated transaction costs for other investments pursued by the Funds.

Further information regarding co-investment arrangements is presented in Item 11.

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

Lone Star does not receive any performance-based fees for the services that it performs for the Funds. The General Partner of each Fund, which is a related person of Lone Star, receives a "carried interest," which is a certain percentage of the actual returns in excess of certain performance hurdles of each investment made by the relevant Fund. Certain associated persons of Lone Star and Hudson have interests in one or more of the General Partners and receive a portion of such carried interest. Payment of the General Partner's carried interest will generally occur on an investment-by-investment basis after all capital contributed for such investment is returned and a specific preferred return on such investment is realized and paid to the relevant Fund's limited partners. The specific structure of each Fund's carried interest is detailed in its offering documents.

The carried interest arrangement described above could create an incentive for Lone Star to favor a Fund that pays higher carried interest over a Fund that pays lower carried interest when allocating investment opportunities. Lone Star believes, however, that there are safeguards in place that protect against this circumstance. The Funds have typically been structured such that only one Fund is investing in a particular asset class at any given time. When two Funds are investing at the same time, the limited partnership agreement of each of the Funds specifies the types of eligible investments that each of these Funds may make, generally without significant overlap between such Funds. Such safeguards are discussed further in Item 11.



The Employee Investment Vehicles are not subject to carried interest allocations. In addition to the safeguards discussed in Item 11, the conflict of interest represented by managing the Employee Investment Vehicles side-by-side with the Funds is mitigated by the structure of the Employee Investment Vehicles. The Employee Investment Vehicle(s) corresponding to a particular Fund participate in the same investments purchased by the Fund and represent a relatively small percentage of each investment. These structural elements are designed to align the interests of participants in the Employee Investment Vehicles with the interests of the Funds.

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

Lone Star provides investment advisory services exclusively to private funds. Each Fund sets its own minimum investment requirements for investors, which was twenty-five million U.S. dollars for the most recently raised Funds. The General Partner of a Fund may, in its sole discretion, waive the investment minimum.

Each investor participating in the Funds is required to meet certain minimum qualifications applicable to the respective Fund, i.e., the investor must be an “accredited investor” within the meaning of Rule 501 of Regulation D promulgated under the U.S. Securities Act of 1933, as amended (the “33 Act”), and, with respect to the Funds other than Lone Star Fund III (U.S.), L.P. and Lone Star Fund III (Bermuda), L.P. (together, “LSF III”) and Lone Star Fund IV (U.S.), L.P. and Lone Star Fund IV (Bermuda), L.P. (together, “LSF IV”), also must be a “qualified purchaser” as defined in Section 2(a)(51) of the Investment Company Act of 1940, as amended (the “40 Act”). The Funds are not registered under the 40 Act, and the offer and sale of interests in the Funds is not registered under the 33 Act.

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

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

#### ***Origination and Due Diligence***

To identify potential investment opportunities for the Funds, Lone Star monitors target markets for potential sales of assets within the investment objectives of the Funds. Typically, Lone Star will seek potential investment opportunities from institutions such as banks, corporate sellers, or government agencies. The investment professionals at Lone Star responsible for the origination of these investment opportunities rely on their experience in and significant knowledge of the various asset markets, along with new and existing relationships with many of the potential counterparties in those markets, to identify potential investment opportunities. Lone Star’s initial due diligence and analysis generally includes assessment of current and future market conditions for specific assets, assessment of asset sellers and other counterparties, and identification of available financing opportunities from counterparties and third parties. When considering whether, and in what manner, a potential investment opportunity should be financed, Lone Star may consider, among other things, the availability of financing opportunities, the cost of each opportunity, the duration of the financing, the relevant risks of each opportunity, and whether such financing is likely to be obtained, and obtained in a timely fashion.

When evaluating a potential investment opportunity, Lone Star works with Hudson to complete a full financial review and valuation, which includes a complete bottom-up, asset-based due diligence evaluation of the transaction. In conducting this assessment, Lone Star and Hudson use various methods of analysis, which utilize proprietary and third-party data, and are tailored to the type and location of the potential investment being evaluated.



### ***Asset Management and Exit***

In connection with the acquisition of an investment by a Fund, Lone Star and Hudson typically develop an initial business plan for the ongoing management of the new investment (each, a “Business Plan”). Hudson conducts the asset management of each investment in accordance with the current Business Plan. The Regional Presidents periodically review the implementation and ongoing validity of the Business Plan; this review process is discussed further in Item 13. Senior management of Hudson, in consultation with Lone Star, will advise on the appropriate exit for an investment, based on an ongoing analysis of buy versus hold scenarios, with a goal of maximizing overall risk-adjusted investor returns. Depending on the type of investment, the Funds will pursue a variety of exit strategies, including negotiated sales, private auctions, discounted payoffs, foreclosures, debt restructuring, public offerings, and business reorganization/recapitalization.

### ***Single-Family Residential Mortgage-Backed Securities***

In evaluating investments related to RMBS and CDOs, the underlying assets of which generally consist of RMBS, Lone Star relies on proprietary models that assign the probability of future defaults, prepayments and loss severities to the underlying loan collateral. The models consider, among other factors, borrower characteristics and the particular attributes of the loans underlying the securities, as well as projected future prices of residential real estate and interest rates. The resulting projections of future loan performance derived from the models are then applied to the RMBS's payment hierarchy (i.e., waterfall), and the projected cash flow of the security being valued is extracted. In the case of a CDO, the cash flow from each security backing the CDO is then assigned to the CDO's waterfall and the projected cash flow of the CDO is extracted. The resulting prepayment, default and severity assumptions are evaluated under more stressful scenarios to account for macroeconomic uncertainty and various residential real estate price depreciation paths. Market information used includes residential real estate prices, market rents, new and existing property sales, and data from loan servicers regarding modifications. Data from vendors is evaluated as well as public data from trustees of the securities and servicers of the loans.

### ***Corporate Equity and Debt***

In evaluating investments related to corporate equity and debt, Lone Star uses a combination of the discounted cash flow method and the company's multiple methods (i.e., price-to-earnings, price-to-book, EBITDA, etc.). The future performance of the company under evaluation is projected (including liquidation value as necessary), which is calculated using the company's financial statements, credit, business plans, material agreements and other information. In the analysis conducted for corporate bonds and other debt, if it is determined that the company might not survive, the liquidation value of the company is calculated and the price of the debt is determined based on that liquidation value. If it is determined that the company should survive past the maturity of the subject debt, then the price is typically determined by discounting the contractual repayment schedule (although as an alternative scenario, the price may be determined based on the company's liquidation value). Sensitivities are also run on a range of financial variables to evaluate the effects on returns.

### ***Whole Loans***

In evaluating investments related to whole loan assets (including primarily non-performing mortgage loans backed primarily by residential properties, but excluding commercial real estate-secured loans), Lone Star uses a loan-level model. The loan-level model generates and projects loan-level cash flows based on the individual characteristics of each mortgage loan, incorporating estimates of the projected re-performance rates (if any) that can be achieved by the servicer through loan modifications. For mortgage loans that are not expected to re-perform, the loan-level models are used to project liquidation timelines under various probability-weighted liquidation scenarios.



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

For the whole loan assets, the resulting cash flow projections are stress tested to account for various factors, including macroeconomic uncertainty, various price depreciation paths, and asset management strategies.

### ***Commercial Real Estate Assets***

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

As part of the evaluation of commercial real estate loans and CMBS, the underlying collateral is reviewed and a fundamental analysis and evaluation of the collateral is conducted. Data from vendors as well as public data from trustees of the securities and servicers of the loans are evaluated. Third-party analysis solutions are also used to perform necessary analytics. For commercial real estate, real time empirical data is also evaluated. Market color is also sourced from relationships with a network of local sales/leasing brokers and real estate developers who are knowledgeable regarding the applicable markets. Additionally, sensitivity analyses are run to comprehend the effects of alternative market assumptions should events turn out differently than projected.

### **Risks**

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

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

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



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

**Limited Current Return.** The return of capital and the realization of gains, if any, will generally occur only upon the partial or complete disposition of a Fund's investment. Developments in global financial markets over the past few years and new developments in global and local markets, if they occur, may adversely impact the ability of the Funds to dispose of investments at their expected returns. Current returns from investments may vary, as Lone Star generally attempts to maximize realized returns on the disposition of the Funds' investments, and as such, will generally not favor early liquidation of an investment or foregoing potential disposition upside to maximize current returns.

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

**Risks of Investing in Real Estate-Related Assets.** Investments in real estate assets and real estate-related investments are subject to various risks associated with the real estate industry generally, including adverse changes in the financial conditions of tenants, buyers, and sellers of properties; the availability of financing; real estate taxes, interest rates and other operating expenses; insurance; environmental laws and regulations, zoning laws, and other governmental rules and fiscal policies; the relative popularity of certain property types and locations; and the availability of certain construction materials. Developments in global and local financial and real estate markets over the past few years, and new developments in those markets, if they occur, may result in reductions in the value of real property interests. The real estate assets associated with the Funds' investments may be or become non-performing after acquisition for a wide variety of reasons. Such non-performing real estate investments may require a substantial amount of workout negotiations and/or restructuring, which may entail, among other things, a substantial write-down of such loans or assets. Additionally, there has been increased regulatory scrutiny from both state and federal regulators, including without limitation the Consumer Financial Protection Bureau, regarding the acquisition, servicing and securitization of non-performing mortgage loans.

**Risks of Investing in Commercial Mortgage Loans.** The value of the Funds' commercial mortgage loans and the underlying real estate will be influenced by the historical rate of commercial mortgage loan delinquencies and defaults and by the severity of resulting losses. Commercial mortgage loans are generally viewed as exposing a lender to a greater risk of loss through delinquency and foreclosure than lending on the security of single-family residences. The ability of a borrower to repay a loan secured by income-producing property typically is dependent primarily upon the successful operation and operating income of such property rather than upon the borrower's other income or assets, as most commercial mortgage loans provide recourse only to the property itself.

**Credit Risks.** A Fund's investment could lose money if the issuer or guarantor of a fixed income security is unable or unwilling, or is perceived by market participants, ratings agencies, pricing services or others as unable or unwilling, to make timely principal and/or interest payments, or to otherwise honor its obligations. Securities are subject to varying degrees of credit risk, which are often reflected in their credit ratings. The downgrade of the credit of a security held by a Fund may decrease its value. "Opportunistic" assets are



generally considered to have significant credit risk. With respect to the financing strategies and hedging services described above, the Funds may also be subject to the risk that a counterparty to a financing arrangement or derivatives contract may be unable or unwilling to honor its obligations as a result of the counterparty's financial condition or insolvency.

**Risks Associated with Mortgage-Backed Securities.** In general, risk factors discussed herein pertaining to mortgage loans (and the type of property securing such mortgage loans), would similarly pertain to any mortgage-backed security in which the Funds invest. Some or all of the potential mortgage-backed securities acquired by the Funds may not be rated, or may be rated lower than investment grade by one or more nationally recognized statistical rating organizations. The majority of the mortgage-backed securities acquired by the Funds are typically lower-rated or unrated, and the original ratings of many of these securities were withdrawn or downgraded to levels that are significantly below investment grade. Lower-rated or unrated mortgage-backed securities in which the Funds may invest have speculative characteristics that can involve substantial financial risks. Securities rated lower than "B" can be regarded as having extremely poor prospects of ever attaining any real investment standing and may be in default. Existing credit support and the owner's equity in the property may be insufficient to protect the Funds from loss. If the Funds invest in subordinated mortgage-backed securities in particular, the Funds will be first in line among debt holders to bear the risk of loss from collateral delinquencies and defaults. To the extent that the mortgage loans that underlie specific mortgage-backed securities are prepayable, the value of such mortgage securities may be negatively affected by increasing prepayments, which generally occur when interest rates decline.

**Risks Associated with Leveraged Buyouts.** A Fund may structure one or more of its operating company investments as a leveraged buyout, in which the acquisition is financed using substantial amounts of debt secured by the target company's cash flows or other assets. These investments are particularly sensitive to adverse economic factors and other risks associated with leverage generally, which magnify their volatility and may substantially increase the Fund's risk profile. In the event an operating company is unable to generate sufficient cash flow to meet the payment obligations associated with the related acquisition financing, the value of the Fund's equity position in such operating company could be significantly reduced or even eliminated. In addition, such investments are subject to risks generally associated with investments in operating companies, including, without limitation, the possibility that the operating company's management may have economic or business interests or goals which are inconsistent with those of the applicable Fund.

**International Investing.** Lone Star performs services for the Funds on a global basis, and in particular, in North America, Europe, Asia Pacific and Latin America. The Funds may also make significant investments in countries that are considered "emerging markets". Risks to the Funds' investments may result from differences between U.S. and non-U.S. countries, such as the absence of uniform accounting, auditing, and disclosure requirements; less government oversight and other legal and regulatory differences, including weaker investor protections and fiduciary duties; less advanced bankruptcy laws; and difficulty in enforcing contractual obligations. Further risks may involve a country's potential economic, political, or social instability, which can lead to expropriation or confiscatory taxation, higher inflation, nationalization, confiscation without fair compensation, or war and can necessitate reliance on a country's diminished economic and physical infrastructure to support investment activity. Such instability may also lead to fluctuations in currency exchange rates that affect the value of the Fund's investments, and foreign currency and other restrictions imposed to prevent capital flight, which may make it difficult or impossible to exchange or repatriate foreign currency. Lone Star analyzes risks in the applicable countries before recommending investments for the Funds, but no assurance can be given that a country's political, social or economic climate, or particular tax, legal, or regulatory risk might not adversely affect an investment by the Funds. Despite efforts by Lone Star to mitigate some of the foregoing risks, these risks may ultimately limit the Funds' ability to dispose of certain investments or to dispose of certain investments profitably.

**Risks Associated with Investments in Finance Companies, Banks, Bank Holding Companies and other Regulated Institutions.** The Funds may invest in finance companies, banks, bank holding companies or other regulated institutions, which operate in highly competitive environments and are subject to extensive



regulation. These institutions compete against one another for loans, deposits, and other financial services. The Funds may invest in finance companies that may be subject to a larger degree of governmental regulatory oversight and periodic examination than their competitors. Investments in certain types of institutions that provide secured and unsecured loans are highly speculative and subject to various risks, including adverse changes in national or international economic conditions; adverse local market conditions; changes in availability of debt financing; changes in interest rates, governmental rules, and fiscal policies; risks due to dependence on cash flow; risks and operating problems arising out of acts of God and other unanticipated events; uninsurable losses; and other factors that are beyond the control of Lone Star or the Funds.

**Financing and Use of Leverage.** The Funds' ability to achieve or surpass target rates of return on the investments recommended by Lone Star may depend on the ability to access sufficient financing sources on desirable terms. The Funds' investments are typically financed by initially borrowing under the Funds' lines of credit, subsequently to be replaced with SPV level financing that is secured by the specific investment that is being financed. This leverage will increase the exposure of such investments to adverse economic factors such as significantly rising interest rates, increased risk spreads, severe economic downturns or deterioration in the condition of the investment or its corresponding market. Generally, the presence of leverage in the Funds' investments will magnify their volatility and may substantially increase the Funds' risk profile. In the event a specific investment is unable to generate sufficient cash flow to meet a margin call or a principal or interest payment required to maintain the financing arrangements related to that investment, the value of a Fund's equity position in that investment could be significantly reduced or even eliminated.

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

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

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

**Swaps and Derivative Investments.** The Funds may utilize swaps and other derivative transactions to obtain a desired exposure, and such transactions may expose the Funds to unlimited risk of loss. To the extent the Funds invest in repurchase agreements, swaps, and other "synthetic" or derivative instruments, counterparty exposures can develop and the Funds take the risk of nonperformance by the other party on the contract. Transactions such as these, which are entered directly between two counterparties, may expose the parties to the risk of counterparty default.



Derivatives are a financial contract with a value that depends on, or is derived from, an underlying product. Some of the risks generally associated with derivatives include the risks that: (1) the value of the derivative will change in a manner detrimental to the Funds; (2) another party to the derivative may fail to comply with the terms of the derivative contract; (3) the derivative may be difficult to purchase or sell; and (4) the derivative may involve indebtedness or economic leverage, such that adverse changes in the value of the underlying asset could result in a loss substantially greater than the amount invested in the derivative itself or in heightened price sensitivity to market fluctuations. Derivatives markets can be highly volatile. The profitability of investments by the Funds in derivatives depends on the ability of Lone Star to correctly analyze these markets, which are influenced by, among other things, changing supply and demand relationships, governmental, commercial, and trade programs and policies designed to influence world political and economic events, and changes in interest rates. In addition, the assets of the Funds may be pledged as collateral in derivatives transactions. Thus, if the Funds default on such an obligation, the collateral may be at risk.

**Reuse of Collateral.** In connection with swaps and other derivative transactions, a Fund is frequently required to post collateral to transaction counterparties or clearing firms. The amount of such collateral may be material to the Fund. Such collateral may, from time-to-time and without notice to the Fund, be carried in the general account of the counterparty or clearing firm and may be sold, pledged, rehypothecated, assigned, invested, loaned, commingled or otherwise disposed of, or otherwise used in the business of the counterparty or clearing firm without any claim or right of any nature whatsoever of the Fund. A counterparty or clearing firm holding collateral in connection with a swap or other derivative transaction is obligated to return to the Fund assets equivalent to those provided as collateral. Although the Funds seek to enter into transactions with creditworthy counterparties and clearing firms on favorable terms, there can be no assurance that collateral posted to such parties will be returned to the Funds in a timely manner. The insolvency or bankruptcy of a counterparty or clearing firm may result in partial or full loss of collateral posted and may require the payment of substantial legal costs to enforce the right of the Funds to the return of equivalent assets.

**Use of SPVs.** Each Fund will use various SPVs to hold the Fund's investments. The use of these SPVs may involve additional costs of formation, structuring, and operating such entities. Because of the worldwide reach of the investments made by the Funds, these SPVs could be of a type with which Lone Star has less familiarity, and therefore provide additional informational and operational uncertainty or difficulties in managing and disposing of investments through such entities. Some of these entities may be controlled by boards of directors, one or more members of which may, for regulatory or other reasons, not be affiliated with Lone Star or subject to its (or its affiliates') supervision and control. An SPV that holds interests in investments on behalf of a Fund may be structured such that its board of directors must approve asset dispositions. A Fund may not be able to execute the desired exit strategies if the directors of an SPV do not approve asset dispositions in accordance with such recommendations. The Funds may incur investment losses or lost opportunities, may not be able to distribute capital in accordance with their projections, and may incur additional costs as a result of the decisions of directors of such SPVs.

**Investments through Partnerships and Joint Ventures.** The Funds will generally make investments through partnerships, joint ventures, operating companies, corporations, companies, or other entities. Such investments may involve risks not present in direct investments, including, for example, the possibility that an operating company, co-venturer, or partner of a Fund may commit fraud, become bankrupt, or have economic or business interests or goals which are inconsistent with those of the Fund, or that any such operating company, co-venturer, or partner may be in a position to take action contrary to the Fund's objectives. Furthermore, if a co-venturer or partner defaults on its funding obligations, it may be difficult for the Fund to make up the shortfall from other sources. The limited partners of the Fund may be required to make additional contributions to replace such shortfall, thereby reducing the diversification of their investments. Any default by such co-venturer or partner could have an extremely deleterious effect on the Fund, its assets, and the interests of the limited partners. In addition, the Fund may be liable for actions of its co-venturers or partners.

**Risks Associated with Hedging Strategies.** Lone Star or Hudson may recommend that a Fund enter into hedging and similar transactions with respect to foreign currency, interest rate, and other risks where deemed



appropriate and cost effective. There is, however, no assurance that foreign exchange risk and/or interest rate risk can be perfectly hedged or minimized where the magnitude and timing of future cash flows can only be estimated and not known with certainty. Thus, prudent currency and interest rate hedging policies only serve to minimize or reduce these risks, but not to eliminate them completely. There can be no assurance that a Fund will have sufficient liquidity or credit capacity to support the hedging services provided by Hudson, and no assurance that hedging techniques will be available, be available at a reasonable cost, or be sufficient to eliminate these risks. In addition, Lone Star or Hudson may recommend that a Fund hedge the investment's currency or interest rate exposure at an amount less than the expected value of that investment or not at all. In such cases, the Fund may suffer losses from changes in foreign exchange rates or interest rates that may have been recouped through hedging transactions if the investment had been fully hedged. With any hedging transaction there exists a risk that any counterparty to a hedging transaction will not perform as expected. There may also be complications in the enforcement of hedging transactions in the event of partial or total dissolution of a currency block such as the Euro, the imposition of currency controls, or similar currency market disruption to a hedged currency, and litigation between the Funds and the hedging counterparty may result from such complications. Such a disruption to the currency markets may also cause the Funds to be unable to implement hedging transactions in the affected markets for an indefinite period of time.

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

#### **Risks Related to Lone Star's Methods of Analysis**

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

Investment analyses performed by Lone Star may frequently be required to be undertaken on an expedited basis, as may investment decisions made by the investment committees, to take advantage of investment opportunities. In such cases, the information available at the time of an investment decision may be limited, and Lone Star may not have access to detailed information regarding the investment opportunity, such as physical characteristics, structural or environmental matters, zoning regulations, or other local conditions affecting an investment. With respect to real estate-related investments, Lone Star may not be able to undertake all appropriate inquiries into the previous ownership and uses of a property consistent with typical commercial or customary practice. Therefore, no assurance can be given that Lone Star will have knowledge of all circumstances that may adversely affect an investment. In addition, Lone Star may rely upon independent consultants and other third parties in connection with its evaluation of proposed investments; however, no assurance can be given that such parties will accurately evaluate such investments, and the Funds may incur liability as a result of their actions.

#### **Specific Risks Related to Lone Star's Methods of Analysis**

**Analysis of Residential Mortgage-Backed Securities.** The material risks related to evaluating mortgage-backed securities and CDOs backed primarily by mortgage-backed securities, using a credit-based model, include: (1) changes affecting the model inputs used to project performance (such as prepayment speeds, delinquency rates, loss severities and interest rate assumptions); and (2) the potential for new variables (such as foreclosure moratoriums, new governmental programs, and legislative or regulatory changes) to impact actual performance. To address these risks, regular model validation tests are performed and the models are



adjusted to account for changes in the market, including credit trends, servicing trends and legislative and regulatory developments.

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

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

**Analysis of Single-Family Residential Whole Loans.** The material risks related to evaluating loans include: (1) changes affecting the model inputs used to project loan performance and (2) the potential for new variables to significantly impact the likelihood of loan repayment. To address these risks, periodic model validation tests are performed and the models are adjusted to account for changes in the market, including housing trends. Multi-scenario valuations are performed in an attempt to assess downside risk. Non-performing residential mortgage loans also have increased risk of litigation in connection with the foreclosure process. To help mitigate this risk, third-party due diligence vendors may be engaged to review a sample of loans.

**Analysis of Commercial Real Estate Assets.** The material risks related to evaluating CMBS, commercial real estate loans and properties include: (1) changes affecting the model inputs used in the valuations and (2) the potential for new variables to significantly impact the ability to realize a profit on the investment. To assess these risks, on-going surveillance of the market is used to adjust the model for a particular investment, and multi-scenario valuations are performed in an attempt to assess downside risk. Commercial real estate loans and CMBS also have increased risk of litigation in connection with the foreclosure process. To help mitigate this risk, third-party due diligence vendors may be engaged to review a sample of loans.

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

**Market Risks.** The Funds may have some investments that are publicly traded or traded in active private markets. The values of such investments are particularly susceptible to fluctuations based on market trends. Certain worldwide government bodies and central banks have responded to financial market turmoil with extraordinary intervention programs, the success of which has yet to be measured. As a result, credit availability has contracted and financing costs have increased, which have acted as barriers to new, sizeable, leveraged transactions. This reduced (or more expensive) credit availability, along with equity and debt security valuation declines, has negatively impacted the private equity sector. Further changes in stock prices, interest rates, currency exchange rates, or commodity prices could result in changes in the broader marketplace that adversely affect the value of publicly traded investments, particularly with respect to investments located in emerging markets or traded on relatively volatile exchanges. The Funds may invest in publicly traded securities on markets that are relatively illiquid or volatile. The values of such investments are particularly susceptible to fluctuations based on market trends. The Funds may have difficulty disposing of such investments at a price and on terms that are attractive to the Funds.

**Currency Risk.** The Funds may make investments in assets denominated or valued in non-U.S. currencies. To the extent that the Funds invest in securities or assets denominated in or indexed to foreign currencies, changes in currency exchange rates bring an added dimension of risk. Currency fluctuations could negatively impact investment gains or add to investment losses. Although the Funds may attempt to hedge against currency risk, the hedging instruments may not always perform as the Funds expect and could produce losses. Suitable hedging instruments may not be available for currencies of emerging market countries, and an



investment may not be adequately hedged with respect to its currency exposure even if suitable hedging instruments are available.

**Taxation.** Investments in real estate, equity, credit, and other financial assets may be subject to various taxes and duties imposed by the jurisdiction in which such assets reside or operate. Depending on the jurisdiction, some investors in a Fund may be required to take into account their allocable share of the Fund's current year activity, without regard to whether the investor has received or will receive any distributions from the Funds. Accordingly, an investor's tax liability for any taxable year associated with an investment in the Funds may exceed cash distributed to that investor during the taxable year.

Lone Star endeavors to structure each investment to comply with all applicable laws and regulations. However, taxing authorities may challenge a structure and, if successful, additional tax may be owed. Additionally, tax laws in any jurisdiction in which the Funds invest are subject to changes or revocations which may expose the Funds to unexpected taxation and reduce the returns of the Funds.

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

**Regulatory Risks.** There is no assurance that the Funds, their General Partners, Lone Star, Hudson or the SPVs will be able to: (i) obtain all required regulatory approvals not yet acquired, or that may need to be acquired in the future; (ii) obtain any necessary modifications to existing regulatory approvals; or (iii) maintain required regulatory approvals. Delay in obtaining or failure to obtain and maintain in full force and effect any regulatory approvals, or amendments thereto, or delay or failure to satisfy any regulatory conditions or other applicable requirements could prevent operations of a portfolio company, impede the development of real estate assets, delay the completion of a previously announced acquisition or sale to third parties, or otherwise result in additional costs to a portfolio company, or other investment, and in turn the Funds. The global investment strategy of the Funds is subject to complex, changing, and sometimes competing legal, tax, and regulatory regimes throughout the world, and there is a possibility that new or changing regulatory requirements could potentially have adverse effects on the Funds.

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

## **Item 9: Disciplinary Information**

In 2003, LSF IV, together with certain co-investors, purchased, through various non-U.S. entities, a controlling interest in Korea Exchange Bank ("KEB"), a South Korean commercial bank. LSF IV held its interest in KEB through an SPV, LSF-KEB Holdings SCA ("KEB Holdings"), whose statutory manager



was Lone Star Capital Management SPRL. The permanent representative of Lone Star Capital Management SPRL was Michael Thomson, previously the Executive Vice President and General Counsel of Lone Star Americas Acquisitions, LLC (now known as Lone Star North Americas Acquisitions, L.P.) and Director and General Counsel of LSGA. After KEB Holdings assumed control of KEB, several persons affiliated with Lone Star were elected to the Board of Directors of KEB, including Paul Yoo, Ellis Short, Michael Thomson, and Steven Lee (together, the “Lone Star Directors”). Shortly thereafter, KEB, with the unanimous authorization of its Board of Directors, rescued its failing credit card affiliate (“KEB Credit”), in order to avert the latter’s impending insolvency, by merging it into the bank.

In late 2006 and early 2007, the Korean Supreme Prosecutor’s Office (“SPO”) charged Paul Yoo, who was also a senior officer of LSGA’s Korean subsidiary at that time, Lone Star Advisors Korea, L.L.C. (“LSAK”), and, vicariously, KEB and KEB Holdings with violations of the Korean Securities and Exchange Act (“SEA”) in connection with KEB’s merger with KEB Credit, alleging essentially that Mr. Yoo and the other Lone Star Directors conspired to unlawfully drive down the share price of KEB Credit’s shares in advance of the merger, to enable KEB to merge with KEB Credit on more favorable terms. Ultimately (in late 2011 and early 2012), after several decisions and appeals, Paul Yoo and, vicariously, KEB Holdings, were convicted of this charge. Paul Yoo was also found guilty of various other charges relating to (i) failure to appear before the Korean National Assembly, (ii) breach of fiduciary duty relating to manipulation of the reported rates of return for certain investments made in Korea by certain prior Funds (as discussed in more detail below), and (iii) tax evasion relating to the transactions involved in clause (ii) above. Paul Yoo was sentenced to three years imprisonment and a fine of KRW 4.295 billion (approximately USD 3.6 million), which was suspended. The Seoul High Court also imposed a criminal fine of KRW 25 billion (approximately USD 21 million) on KEB Holdings.

Under the SEA as applied in line with the Korean Constitutional Court’s prior rulings, a court must find that a company’s legal “representative” was involved in alleged violations in order to convict the company. The Seoul High Court’s decision against KEB Holdings was based on the activities of Michael Thomson, whom the Court considered to be the legal “representative” of KEB Holdings for purposes of the SEA. No charges were brought against Ellis Short, Michael Thomson, or Steven Lee, the other Lone Star Directors. No Lone Star Director other than Paul Yoo participated in the proceedings. Lone Star has been advised by Korean counsel that the court’s finding against KEB Holdings is not a conviction against these individuals personally.

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

In 2005, LSAK and Hudson Advisors Korea, Inc. (HAL’s affiliate in Korea at that time) (“HAK”) discovered that a senior officer of LSAK had embezzled substantial amounts from LSAK, HAK, and certain related entities of the Funds over a period of several years, mainly through fictitious invoices for services ostensibly provided by third parties. The officer was terminated, confessed to the embezzlement, and made restitution of the amounts embezzled plus costs and damages. Following the reporting of these events, the FSC conducted its own investigation, and upon its findings (1) issued a “business improvement order” to HAK based on HAK’s alleged violation of the Asset-Backed Securities Act (“ABSA”) and (2) imposed a sanction of “suspension of payment of service fees to non-residents for one year” on HAK for violation of the Foreign Exchange Transaction Act (“FETA”) relating to the fraudulent money transfers that were made offshore. The FSC also imposed a sanction of “suspension of payment of service fees to non-residents for one year” on LSAK.

With respect to the business improvement order, the FSC alleged that HAK improperly serviced and managed the assets of certain ABS specialty companies in which certain Funds were invested and caused these companies to violate provisions of the ABSA. As part of the business improvement order, HAK was



required to return a service fee improperly charged to the ABS specialty companies. The FSC also required HAK to (1) establish an internal control system with respect to services and (2) establish an external control system, including retaining an external auditor to provide an auditor's report, which would be delivered to the FSC for two years (the "Covered Period"), and providing the FSC with statements regarding certain transactions by the ABS specialty companies during the Covered Period. Additionally, HAK was required to submit to the FSC a plan for taking measures against the officers/employees involved in the acts related to the ABS specialty companies.

The FSC imposed the sanction of "suspension of payment of service fees to non-residents for one year" on HAK and LSAK for their alleged violations of the FETA relating to the former employee's improper offshore money transfers. As background, the FETA requires that a Korean resident who makes a third-party payment must submit a report thereof to the Governor of the Bank of Korea, and submit certain documents to the president of a foreign exchange bank. The FSC determined that HAK and LSAK violated these provisions because they made some third-party payments without submitting a report to the Governor of the Bank of Korea and submitted a forged consulting agreement with a non-resident to the president of a foreign exchange bank.

In addition, the SPO charged (i) Mr. H.C. Cheong, the President of HAK, with breach of fiduciary duty for manipulation of the reported rates of return for certain investments made in Korea by certain prior Funds (similar to the charge above against Mr. Yoo), embezzlement and tax evasion, and (ii) an entity that was 50% owned by LSF III, vicariously for Mr. Cheong's tax evasion charge. Although Mr. Cheong was acquitted on most of these charges, including the one for which the LSF III investment affiliate was vicariously charged, he was convicted of certain of the breach of fiduciary duty charges and certain of the tax evasion charges.

On November 21, 2012, certain related entities of the Funds initiated arbitration against the government of the Republic of Korea with the International Center for Settlement of Investment Disputes, claiming damages suffered as a result of the Korean government's unlawful interference with those entities' investments in Korean companies (including KEB). The claims arise out of the government's failure to comply with its obligations under the investment treaty between Belgium and South Korea. The last arbitration hearings were held in June 2016, and a decision is expected from the tribunal sometime during 2018.

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

### **CFTC**

LSGA is registered with the Commodity Futures Trading Commission (the "CFTC") as a commodity pool operator and commodity trading adviser and is a member of the National Futures Association (the "NFA"). HAL is registered with the CFTC as a commodity trading adviser and is a member of the NFA. The Funds currently rely on an exemption from registration provided by Rule 4.13(a)(3) under the Commodity Exchange Act (the "CEA"). In addition, LSGA relies on an exemption provided by Rule 4.7 under the CEA to pools whose participants are limited to "qualified eligible persons" with respect to certain investment entities that are subsidiaries of certain Funds and that may be defined as commodity pools. Pursuant to this exemption, offering memoranda for the Funds as well as such subsidiaries are not required to be, and will not be, filed with the CFTC.

### **Relying Advisers**

The following entities are registered with the SEC in reliance on the investment adviser registration of LSNAALP:

- Lone Star Global Acquisitions, Ltd.
- Lone Star Global Acquisitions, LLC
- Lone Star North America Acquisitions, LLC



- Lone Star Canada, LLC
- Lone Star Latin America Acquisitions, LLC
- LSGA Holdings, Ltd.

The filing adviser and the relying advisers share a common compliance program, including a Code of Ethics and other compliance policies and procedures.

### **Participating Affiliates**

The below direct or indirect subsidiaries of LSGA established outside of the United States assist LSGA in rendering investment advice (the “Participating Affiliates”). As noted, certain Participating Affiliates are registered with regulatory authorities as required under local law. The Participating Affiliates and their employees are subject to LSGA’s oversight, its Code of Ethics and other compliance policies and procedures adopted pursuant to the requirements of the U.S. Investment Advisers Act of 1940 (“Advisers Act”), as applicable (in addition to applicable local laws and regulations).

- Lone Star Argentina Acquisitions S.R.L.
- Lone Star Asia-Pacific Acquisitions (Hong Kong) Limited (registered as an asset manager with the Hong Kong Securities and Futures Commission)
- Lone Star Asia-Pacific Acquisitions (Singapore) Pte. Ltd. (licensed for fund management with the Monetary Authority of Singapore)
- Lone Star Brasil Acquisitions Participacoes Ltda.
- Lone Star Europe Acquisitions Limited (registered as a corporate finance advisory firm with the U.K. Financial Conduct Authority)
- Lone Star France Acquisitions SARL
- Lone Star Germany Acquisitions GmbH
- Lone Star Japan Acquisitions, Ltd. (registered as an investment adviser with the Kanto Financial Bureau, which operates under the authority of the Japan Financial Services Agency)
- Lone Star Netherlands Acquisitions B.V.
- Lone Star Portugal Acquisitions, S.A.
- Lone Star Spain Acquisitions S.L.U.

### **General Partners**

As noted above in Item 4, the General Partners of each Fund are related persons of Lone Star. The General Partners have, on behalf of each Fund, granted to LSGA the authority to provide advisory and other services to the Funds.

### **Hudson**

As noted above in Item 4, Hudson has been engaged to provide due diligence and analysis, asset management, and ancillary services to the Funds. HAL and the following direct or indirect subsidiaries of HAL that provide such services are related persons of Lone Star:

- Hudson Americas L.P.
- Hudson Advisors Argentina S.R.L.
- Hudson Advisors Asia-Pacific, Limited
- Hudson Assessoria Brazil Limitada
- Hudson Advisors (Canada), LLC
- Hudson Advisors Europe Designated Activity Company
- Hudson Advisors France SARL



- Hudson Advisors Germany GmbH
- Hudson Advisors Ireland Designated Activity Company
- Hudson Japan K.K
- Hudson Advisors Luxembourg S.a.r.l.
- Hudson Advisors Netherlands, B.V.
- Hudson Advisors Portugal, Unipessoal, Lda.
- Hudson Advisors (Shanghai) Co., Ltd.
- Hudson Advisors Spain S.L.U.
- Hudson Advisors UK Limited

Lone Star believes that use of Hudson as a service provider to the Funds provides several benefits, including cost, quality of service, and speed of execution. However, use of Hudson also presents certain conflicts of interest for Lone Star. Because Lone Star is a related person of Hudson, they may have an incentive to increase the fees received by Hudson from the Funds. Conflicts may also arise in determining whether Hudson has performed its obligations to the Funds. These conflicts are mitigated through structural and procedural approaches. The parameters of fee arrangements between Hudson and each Fund are either approved by the limited partners of such Fund as part of its limited partnership agreement (attached as a schedule to the agreement) or by the Advisory Committee of the applicable Fund. Any amendments or exceptions to these fee parameters require approval by the Advisory Committee of the applicable Fund. Because of their interests in the General Partners (and in some cases, the Employee Investment Vehicles), members of management of Lone Star are incentivized to monitor the cost and quality of all services received by the Funds, including from Hudson. In addition to the investment reviews described in Item 13 below, Lone Star and Hudson review cost and efficiency metrics regarding the services provided by Hudson. Lone Star also periodically compares the fees charged by Hudson against fees charged by third-party service providers.

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

### **Code of Ethics**

Lone Star has adopted a global regulatory compliance manual that sets forth certain standards for its employees, including a Code of Ethics which contains the following policies: Code of Conduct, Gifts and Entertainment Policy, Outside Business Activities Policy, Personal Trading Policy, Market Abuse Policy, and Political Activities Policy (collectively, the “Code”). Lone Star adopted the Code in accordance with Section 204A of the Advisers Act. The Code emphasizes Lone Star’s fiduciary duty to place the interests of the Funds before the interests of Lone Star and its employees, including proper management of conflicts of interest.

Under the Code, employees are generally required to pre-clear personal investment transactions with Lone Star’s Chief Compliance Officer or designee, including transactions by others in their household. Employees are also required to periodically report personal and household investment accounts and holdings. The Code generally restricts the purchase and sale by employees of investments held by Lone Star’s clients. The Code also addresses pre-clearance and reporting obligations of employees with respect to gifts and entertainment given and received, political contributions, and outside business activities.

Lone Star will provide a copy of the Code to any client, prospective client, or Fund investor or prospective investor upon written request to the Chief Compliance Officer, Lone Star North America Acquisitions, L.P., 2711 N. Haskell Avenue, Suite 1700, Dallas, Texas 75204.



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

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

None of Lone Star, its employees, Hudson, or their related persons invest in opportunities recommended to the Funds, except for investments in the Employee Investment Vehicles, investments in certain other Co-Investment Vehicles authorized by the offering documents of the relevant Funds, interests held directly by General Partners in the Funds, limited partnership and other ownership interests in the General Partners held by certain associated persons of Lone Star and Hudson, and limited partnership interests in certain Funds held by certain associated persons of Lone Star and Hudson. Lone Star will not, as principal, transact in securities with the Funds without first disclosing in writing Lone Star's capacity in the transaction and obtaining the consent of the Advisory Committee(s) of the relevant Fund(s).

HAL or an affiliated entity may, from time-to-time and in limited circumstances, advance funds to a Fund as necessary for the Fund to pay its operating expenses and/or satisfy margin calls or other financing needs. HAL will not make advances for investment purchases by a Fund. Additionally, any such advances by HAL or an affiliated entity will not be included in the Fund's assets under management for purposes of calculating fees for asset management services. HAL does not receive any interest with respect to such advances, but HAL is generally entitled to seek reimbursement at times when the Fund has sufficient working capital and the payment of such reimbursement would not require the Fund to liquidate any of its investments that it would not otherwise liquidate. HAL's right to be repaid any outstanding advances will be senior in priority to the Fund's investors' distribution rights from the Fund. Such advances are at HAL's or its affiliates' sole discretion, and there can be no assurance that HAL or its affiliates will continue to provide such advances in the future. If HAL is unwilling or unable to make such advances in the future, a Fund may be required to seek other sources of funds in order to meet its financing needs, and may be required to pay interest on such funds.

### ***Employee Investment Vehicles***

The Employee Investment Vehicles co-invest with the Funds in each investment that the Funds acquire. The Employee Investment Vehicles do not make any differing or separate investments from the Funds. The terms of the corresponding Employee Investment Vehicles are disclosed in the offering documents of the applicable Funds.

The Funds whose final closings occurred prior to 2009 made financing available to Key Employees participating in Employee Investment Vehicles through a promissory note that bears interest at a commercial rate and on a full recourse basis with the Key Employee's interest in the co-investment as collateral. The amounts borrowed are generally repaid from a portion of any and all distributions from the co-investment. The General Partner of a Fund may, under certain circumstances such as the death or incapacity of a Key Employee, and in its sole discretion, purchase such a loan from the relevant Fund for an amount equal to the outstanding principal and accrued interest of the loan. In such cases, the General Partner will enter into arrangements to ensure that any profit associated with such a purchase is repaid to the Fund. With respect to Funds whose final closings occurred after 2009, LSGA, HAL and/or one or more of their respective affiliates may provide financing, directly or indirectly, to Key Employees who participate in an Employee Investment Vehicle.

The Employee Investment Vehicles are designed to align the interests of Lone Star's and Hudson's Key Employees with those of the Funds. The Key Employees who participate in the Employee Investment Vehicles have personal assets at risk alongside the investors in the applicable Fund. These arrangements do, however, present conflicts of interest. For example, the financing provided to Key Employees may be extensive, may have a significant effect on the net worth of these employees, and may influence employees responsible for the provision of investment advice to recommend higher risk investments than they otherwise would. The personnel of Lone Star, Hudson, and their related persons who participate in an Employee Investment Vehicle



may have an incentive to recommend the acquisition or disposition of assets based on their personal interests (which could include the obligation to repay financing provided by HAL and/or one of its subsidiaries) rather than the best interests of the applicable Fund. Also, because participants in the Employee Investment Vehicles typically decide whether to invest at a later time than the investors in the Funds, the participants in the Employee Investment Vehicle may, at the time of their investments, have information regarding potential investments that may be more comprehensive than information known by the Funds' underlying investors at the time they made their investments. In addition, employees who participate in the Employee Investment Vehicles may not be financially able to meet capital calls.

Lone Star believes that there are factors with respect to the Employee Investment Vehicles that mitigate the conflicts of interest discussed above. Once a Key Employee decides to participate in an Employee Investment Vehicle with respect to the Funds currently in their investment periods, that Key Employee has no ability to opt out of the Employee Investment Vehicle's future investments. Lone Star and Hudson will decide on the amount of the Employee Investment Vehicle's participation in each investment (within a range provided in the applicable Fund's offering documents). Accordingly, the maximum contribution an Employee Investment Vehicle can make to an investment is immaterial in relation to the total investment made by the participating Fund. Lone Star has implemented policies and procedures, including the Code, that are designed to mitigate and properly manage any conflicts of interest and to require employees to act in the best interests of Lone Star's clients at all times.

Consistent with the limited partnership agreement of each Fund, the Fund may temporarily fund the entire cost of the initial acquisition of an investment, subject to the Employee Investment Vehicle's obligation to reimburse the Fund after the Fund calls capital from its investors for the investment. Amounts temporarily funded by the Fund accrue interest that is paid to the Fund together with the reimbursement of capital. With respect to an initial investment, the Employee Investment Vehicle shares in the risks and benefits of hedging and financing transactions that occur prior to reimbursement of the Fund, although the Fund is directly exposed to the Employee Investment Vehicle's share of these risks, as well as investment-related risks, prior to reimbursement.

When executing certain hedging transactions, Hudson aggregates orders for the applicable Funds and any Employee Investment Vehicle invested in an asset. When aggregating orders, Hudson determines the total amount to be hedged for such investment, executes the hedging transaction for the applicable Funds on a collective basis, and then allocates the trade among the Funds and any Employee Investment Vehicle invested in the asset, based on their respective capital commitments.

### **Other Conflicts of Interest**

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

Each Fund structure typically consists of a limited partnership organized in the United States and a corresponding exempted limited partnership formed in Bermuda (such fund structure organization, the "U.S./Bermuda Funds"). When a Fund is investing, its U.S./Bermuda Funds will invest on a side-by-side basis in proportion to the respective capital commitments of each Fund. Likewise, the Employee Investment Vehicles invest on a side-by-side basis with the U.S./Bermuda Funds pursuant to co-investment agreements. Pursuant to these agreements, certain expenses of an investment transaction may be paid by one of the U.S./Bermuda Funds, and subject to reimbursement by the other U.S./Bermuda Fund and any associated Employee Investment Vehicle. In such circumstances, the U.S./Bermuda Fund that has paid these expenses bears the risk that the other U.S./Bermuda Fund or the Employee Investment Vehicle will not have sufficient capital to reimburse the expenses in a timely fashion, or at all.

The limited partnership agreements of the Funds currently in their investment periods provide contractual safeguards regarding how a potential investment is chosen for a particular Fund. Specifically, each of the limited partnership agreements describes the types of investments that each of the Funds can make



without overlap between them. In situations where a potential investment may be suitable for more than one Fund, the portfolio may be purchased by the Fund whose permitted investments are most predominantly aligned with the potential investment (even though the investment may contain some assets that could be purchased by the other Fund).

In limited circumstances, a Fund may sell assets to, purchase assets from, or otherwise share in an investment transaction with another Fund. To address conflicts of interest, Lone Star has implemented policies and procedures to require that all clients be treated fairly and equitably. The limited partnership agreement of each applicable Fund requires prior approval of conflicts of interest between Lone Star and a Fund or among Funds, including proposed cross or principal transactions, by an advisory committee of investors created pursuant to the Fund's limited partnership agreement (each, an "Advisory Committee"). Neither Lone Star nor any of its employees serve as voting members of the Advisory Committees of any of the Funds.

In some circumstances, an operating company owned by one or more Funds ("Portfolio Company") may be engaged to provide services to one or more other Funds, Lone Star, or Hudson. As an example, Portfolio Companies that provide loan servicing or property management have been engaged to provide services with respect to assets owned by Funds that do not own the Portfolio Companies. Such arrangements pose conflicts of interest similar to cross or principal transactions. Pursuant to the terms of the limited partnership agreements of the applicable Funds, the terms of such arrangements must be commercially reasonable and competitive with amounts that would be paid to third parties on an "arms-length" basis. Such arrangements must also be either approved by the applicable Funds' limited partners as part of those Funds' limited partnership agreements or approved by the Advisory Committees of such Funds.

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

### ***Co-Investment Allocation***

As noted above, a small portion of each investment by the Funds is allocated to Employee Investment Vehicles. In addition, the General Partner of each Fund is permitted to offer a portion of any investment to other parties, at its sole discretion. It may offer co-investment opportunities to Fund investors through one or more Co-Investment Vehicles. If it elects to do so, a General Partner generally must offer investors in the applicable Fund the opportunity to invest in a Co-Investment Vehicle pro rata based on the level of their commitments to the Fund, subject to the terms of the applicable Fund's offering documents. Each General Partner is also permitted to allocate a portion of any investment to any party who has a right to co-invest under an agreement with the General Partner, Lone Star or the Fund, or that the General Partner or Lone Star determines is necessary or desirable for the consummation or success of the investment (which may include investors in the applicable Fund or other Funds). For example, such co-investment may be offered to parties that assisted with origination or financing of the investment, or that will be involved with management of the investment going forward.

Apart from the constraints described above, Lone Star and the General Partners are under no obligation to offer co-investment opportunities to any party with respect to any particular Fund or investment, or to allocate any such opportunities offered in any particular manner. Potential co-investors may have a variety of different relationships with the Funds, the General Partners or Lone Star, creating potential conflicts of interest for the General Partners in determining any co-investment strategy. In addition, as noted in Item 5, fee and expense arrangements for co-investors are often different from those of the Funds. In accordance with their fiduciary



duties to the Funds, Lone Star and the General Partners seek to use co-investments to align the interests of other stakeholders with those of the Funds and/or to provide additional capital needed to complete an investment, but there can be no assurance that these objectives will be fully achieved in each case.

### ***Transactions with Investors***

The Funds or SPVs occasionally enter into transactions with investors or potential investors in the Funds. For example, a Fund investor may be invited to bid on an asset being sold by a Fund. Such transactions create potential conflicts of interest for Lone Star, which may be motivated to confer a benefit on an investor in order to encourage investment in future Funds or gain support on matters requiring investor approval. Lone Star has implemented policies and procedures designed to ensure that any such transactions are in the best interests of the applicable Funds and are carried out on an arm's-length basis.

### ***Expense Allocations***

The expenses discussed in Item 5 are typically incurred by a single Fund (or by the applicable U.S./Bermuda Fund pair). In some instances, expenses may be shared by multiple Funds. This creates conflicts of interest for Lone Star in some instances, as the allocation of such expenses may impact the performance of different Funds, as well as management fees and promote allocations of such Funds. Lone Star allocates such expenses in its sole discretion exercising good faith. Lone Star has implemented policies and procedures designed to ensure that expense allocations are equitable and consistent with the requirements of the applicable offering documents. Certain expenses shared by one or more Funds may be initially paid by a single Fund, which is reimbursed by other Funds for their appropriate share of the relevant expenses.

### ***Possession of Material Non-Public Information***

Lone Star periodically comes into possession of material, nonpublic information with respect to investment targets and other public companies in connection with advising the Funds. Lone Star maintains policies and procedures designed to protect such information in accordance with applicable regulations, including maintenance of internal watch and restricted lists. Lone Star also maintains policies and procedures designed to ensure the confidentiality of client information generally. However, Lone Star generally does not maintain formal "information barriers" between different groups. As a result, possession of material, nonpublic information by Lone Star will generally limit the ability of the Funds to buy or sell the applicable company's securities. In addition, the Funds or their affiliates sometimes enter into confidentiality agreements that include provisions, such as "standstills", that limit the ability of affected entities to buy or sell certain securities, potentially for extended periods.

Hudson also periodically comes into possession of material, nonpublic information with respect to investment targets and other public companies in connection with advising the Funds and other clients. Hudson maintains policies and procedures designed to protect such information in accordance with applicable regulations, including maintenance of internal watch and restricted lists. Hudson also maintains policies and procedures designed to ensure the confidentiality of client information generally. However, Hudson generally does not maintain formal information barriers between different groups. Further, Lone Star and Hudson generally do not maintain formal information barriers between their operations. As a result, possession of material, nonpublic information by Hudson will often limit the ability of the Funds to buy or sell the applicable company's securities.

### ***Valuation***

The Funds' investments include numerous illiquid, subordinate, non-traded, or lightly traded investments held in a variety of countries for which market values are not readily available and fair values may be difficult to estimate. Lone Star could be motivated to misstate the value of investments in the Funds' accounting records or on investor reports in order to improve the performance presented to investors or potential investors or to



minimize write-downs impacting incentive allocations and management fee payments.

In order to address these risks, Lone Star and the General Partners employ rigorous valuation policies and procedures, supported by Hudson. All Fund investments are reported at fair value in accordance with U.S. generally accepted accounting principles, following the Financial Accounting Standards Board's Accounting Standards Codification ("ASC") 820, Fair Value Measurements. If reliable market quotations are readily available, securities and other instruments will generally be valued at their market price. Otherwise, investments will be fair valued using methodologies deemed by management to be most appropriate for the investment type and market conditions. When available, methodologies are used that maximize the use of observable inputs. Due to the nature of the Funds' investments, valuations are often based on discounted cash-flow projections, market multiples, or other valuation methodologies that rely heavily on management judgement and estimates of unobservable inputs. There can be no assurances such valuations, or their underlying assumptions, will prove to be accurate.

Each quarter, a Fair Value Review Committee comprised of senior managers in Hudson's Fund and Investment Reporting Department, the Senior Managing Director – Portfolio Management & Operations for Lone Star, and the Chief Compliance Officer for Lone Star and Hudson reviews the valuation and valuation methodology for each Fund investment. After the Fair Value Review Committee has approved quarterly valuations, they are submitted to the Fair Value Approval Committee. The Fair Value Approval Committee is comprised of the President of LSGA, the Senior Managing Director – Portfolio Management & Operations for Lone Star, the Chief Operating Officer of HAL, and the Chief Financial Officer of HAL. The Fair Value Approval Committee must approve the fair value balance and discount rate for each investment before such valuations are reported to investors of the Funds.

## **Item 12: Brokerage Practices**

### **Counterparty Selection**

Lone Star seeks to trade assets on behalf of its clients in a manner that is fair and equitable to all clients, and to exercise diligence and care throughout the transaction process. The majority of the Funds' assets are not market-traded instruments and even in the limited circumstances where a Fund invests in market-traded instruments, often these are unique assets that are only available from one or a limited number of counterparties (i.e., there is no meaningful market). The investment counterparty is typically chosen as part of the Investment Committee's approval of the investment, and Hudson then assists in implementing the investment decision. Therefore, the traditional best execution concepts that apply to market-traded instruments do not easily apply to the majority of the assets that Lone Star trades on behalf of its clients.

In those cases where Lone Star selects broker-dealers or other counterparties for transactions in market-traded instruments on behalf of its clients, Lone Star will do so consistent with its duty of best execution. Lone Star defines "best execution" as seeking to obtain the best terms for its clients under the particular circumstances occurring at the time of a transaction and taking into account the overall objective for the investment to which the transaction relates. It is the policy of Lone Star to seek to achieve the best qualitative execution under the circumstances. Best execution does not require Lone Star to obtain the lowest possible price, commission or transaction cost. Transactions may involve specialized services or considerations (such as the type of assets the client is seeking to purchase or sell, or the availability of financing opportunities to the applicable client) that must be considered when selecting a counterparty, and thereby entail higher markups or commissions than would be the case with transactions that do not involve any specialized services or considerations. Furthermore, because Lone Star's clients typically invest in assets that may be purchased from only one or a small number of counterparties, Lone Star may not be able to obtain terms that are as favorable as those that may be available in a market with more potential counterparties.

In seeking best execution, Lone Star may consider the full range and quality of a counterparty's services, including, among other things, one or more of the following factors, as applicable:



- the counterparty's ability to present Lone Star with a transaction that meets the investment objectives of the relevant client for whom the transaction is executed, including a counterparty's ability to source unique assets that may be held by a limited number of entities or by a single entity;
- the best price possible under the particular circumstances of the transaction (for example, for a sale transaction, Lone Star may determine that the best price may be obtained through a competitive auction process open to a number of counterparties or, alternatively, Lone Star may determine that the best price may be achieved through price negotiations with a limited number of counterparties);
- the ability of the counterparty to provide financing on the assets purchased, including either bridge financing until permanent financing can be obtained or long-term financing at inception on terms which Lone Star believes are in the best interests of the relevant client (which considerations may include, amongst others, rate, term, recourse and asset management flexibility) (for a sale transaction, Lone Star may take any breakage costs related to a financing and the willingness of a counterparty to waive such breakage costs into consideration);
- the counterparty's credit terms prior to requiring the posting of margin;
- the counterparty's ability to commit capital needed to execute the transaction;
- the ability and history of the counterparty to maintain confidentiality of a transaction (or prior transactions);
- the ability of the counterparty to execute quickly and the ability to commit capital and/or financing quickly in light of the size of the transaction;
- the reliability, integrity, reputation and execution capability of the counterparty for effecting transactions in light of the size and difficulty of executing the order;
- the financial strength and creditworthiness of the counterparty; and
- the counterparty's specialized knowledge or experience in a particular market.

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

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

During fundraising periods, the General Partners of the Funds may use the services of a placement agent. All fees and expenses paid to the placement agent are ultimately the responsibility of the General Partner of the applicable Fund, as governed by the provisions of the applicable Fund's limited partnership agreement. Neither Lone Star nor Hudson considers, when selecting counterparties, whether a potential counterparty provides referrals of investors to the Funds; Lone Star and Hudson select counterparties pursuant to one or more factors described above under "Counterparty Selection."

### **Other Third Parties**

In addition to transactions with banks and broker-dealers, Lone Star may engage other service providers on behalf of the Funds with respect to the execution of transactions, such as lenders and real estate brokers and agents. These service providers are subject to similar selection criteria as broker-dealers, but may also be



selected based on the geographic location of the assets and the service provider's experience with the type of assets involved.

### **Aggregation of Client Transactions**

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

### **Trade Errors**

Although Lone Star seeks to exercise diligence and care when trading assets on behalf of the Funds, errors may occur during the trading process. Lone Star attempts to minimize trade errors by promptly reconciling confirmations with trade tickets or similar transaction documentation. To the extent that a trade error occurs, Lone Star works to correct the error as soon as practicable and in such a manner that any resulting loss is minimized. If a trade error results in a gain, the affected Fund(s) will retain the gain. As described in the applicable Fund's offering documents, any loss caused by a trade error will be borne by the affected Fund(s) unless the error is the result of bad faith, gross negligence or willful misconduct by Lone Star. Lone Star does not use commitments of future brokerage business to compensate any broker-dealer for absorbing the cost of a trade error. However, to the extent Lone Star can demonstrate that a counterparty was partly or entirely responsible for a trade error, Lone Star may ask that counterparty to bear part or all of the cost of the error.

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

A detailed Business Plan for each investment is generally developed within 90 days after closing an acquisition. At least quarterly thereafter, each Regional President and other Lone Star representatives meet with senior management of Hudson and the applicable asset management teams for the region to review the status and performance of each investment against the Business Plan and current market conditions. As needed, Hudson will review updates to Business Plans with Lone Star (and in some cases with directors of applicable SPVs). In addition to formal quarterly reviews, investments may be reviewed on a more frequent basis as needed to consider financing or sales opportunities, or to develop additional asset management strategies.

On a quarterly basis, HAL prepares for the General Partner of each Fund an unaudited balance sheet, statement of operations, portfolio cash flow summary and status reports of the Fund's investments and activities during the applicable period, including summary descriptions of material new acquisitions and material dispositions. LSGA, on behalf of the General Partner, distributes (1) the unaudited statements and accompanying reports to the limited partners in each Fund on a quarterly basis (typically within 45 days after the end of each quarter) and (2) audited financial statements on an annual basis (typically within 90 days of the Fund's fiscal year end).

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

Lone Star does not receive economic benefits from a non-client for providing investment advice or other advisory services to its clients. Lone Star, Hudson, the General Partners, or their affiliates may on occasion receive certain fees from third parties with respect to the business of the Funds, including financial advisory, director, or transaction-related fees ("Additional Fees"). Any such Additional Fees will be offset against management fees or expenses payable by the affected Fund(s) to its General Partner or to LSGA.

Lone Star does not have advisory clients other than the Funds and certain related entities. Neither Lone Star nor its related persons directly or indirectly compensate any third party for advisory client referrals. Lone Star may enter into placement agent arrangements with unaffiliated third parties regarding the solicitation of investors to the Funds for compensation. Lone Star has entered into a placement agent agreement with respect



to solicitation of investors in Latin America, and such placement agent is paid a fee based on the amount of capital committed by each investor solicited by the placement agent and accepted by the General Partner of the applicable Fund. All fees and expenses paid to the placement agent are ultimately the responsibility of the General Partner of the applicable Fund, as governed by the provisions of the applicable Fund's offering documents.

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

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

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

Lone Star provides investment advisory services involving a significant amount of investment discretion to the Funds. Although each General Partner may impose restrictions on Lone Star, it is not anticipated that a General Partner would do so.

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

Lone Star does not engage in proxy voting on behalf of its clients.

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

Lone Star does not require or solicit prepayment of fees.

Lone Star has never filed for bankruptcy and is not aware of any financial condition that is expected to affect or is reasonably likely to impair its ability to meet contractual obligations to clients.