

## Performance

Having experienced what has been universally accepted to be the worst year in the financial markets in recorded history, the Foundations Program held up well in 2008. We mentioned in our previous newsletter that we had experienced some difficulties in the pricing of some of the assets within the portfolio and this led to the delay in the profit reporting and allocation decision for the 4<sup>th</sup> quarter 2008. Now that these issues have been resolved, it can be seen that the portfolio made a loss of 1.51% for the 4<sup>th</sup> quarter of 2008. Having made no loss allocation in September, some of the 4<sup>th</sup> quarter loss will be allocated to participants after the offset of the unallocated profit buffer. So, overall, 2008 was slightly down for our participants which, when compared to the average market losses of circa 30 - 40% over the same period, is a very positive result for our participants and a testament to our cautious borrowing and investment model.

Looking forward to 2009, the Program sustained a loss in the first quarter of 5.59%. This was mainly due to the prevailing market conditions but also, in December 2008, we were unable to include two additional sources of expected value from two holdings in the Portfolio. We expect these to come through in due course but we have not yet been able to accrue them in the figures.

## Pricing of assets in the Program Portfolio

There is a change in the basis of the reporting. Until June 2008 we reported on the quarterly percentage return from the NAV of the fund, as borrowings were drawn down according to the Participation exposure rules (i.e. the write down of the assignment based on risk, and then the gradual building up of loan in consecutive months.) In the latter half of June however, we paid back substantial amounts of the loan and this has continued throughout the lending crisis – over 60% of our target borrowing has been paid back. In order to keep the reporting consistent with the past, from July 2008 we are reporting returns against the Participation exposure, as this is the amount of client security exposed to participation risk. In other words, we are matching the return percentage to where it would have been at normal levels.

## Lending facility and annual accounts

The fund has finally secured a method of breaking away from the borrowing deadlock. We are about to close a relationship with a highly respected organisation based in the USA, which will facilitate a complete re-vamp of our lending and securitisation within the Program. This is good news following a period of over 9 months of protracted negotiations with alternate lenders. Since last year, we have been in discussion with over 30 institutions that expressed an interest in performing the lending function and developing a relationship with the Program. However, as the banking crisis deepened, we were unable to obtain acceptable terms and have managed to extend the original facility whilst working on alternative solutions to the lending deadlock and although we are delighted to have succeeded in this task, the delay in finalising a new arrangement has led to increased costs and as a result, losses for the Program.

The accounts will be signed off and published once the new lending and securitisation arrangements are in place.

## Arch Fund holdings in the Portfolio

The Arch holdings in the Program portfolio experienced a drop in March 2009. We believe that the lowest value for these funds is expressed in the March report, and shown in our figures. The Program had a 26% exposure to Arch Guernsey funds based on the current reduced levels of borrowing. As a result of these factors, and an incremental borrowing charge for the first quarter 2009, we have a loss of 5.59% on participation. As a percentage of all assignments at risk this is less at 3.21%. Whilst this is a relatively high figure we are confident that the re-inflation of

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|                                    |                       |
|------------------------------------|-----------------------|
| <b>Seven months to 31 Dec 2005</b> | 3.17%<br>(annualised) |
| <b>Calendar year 2006</b>          | 3.6%                  |
| <b>Calendar year 2007</b>          | 4.22%                 |
| <b>First quarter 2008</b>          | -1.45%                |
| <b>No allocation</b>               |                       |
| <b>Second quarter 2008</b>         | 2.41%                 |
| <b>No allocation</b>               |                       |

*Based on profit generated per average NAV of investments made*

|                            |        |
|----------------------------|--------|
| <b>Third quarter 2008</b>  | -0.93% |
| <b>No allocation</b>       |        |
| <b>Fourth Quarter 2008</b> | -1.51% |
| <b>No allocation</b>       |        |

*Based on Participation exposure*

|                           |        |
|---------------------------|--------|
| <b>First quarter 2009</b> | -5.59% |
|---------------------------|--------|

*Based on Participation exposure*

### Important Note

The Program return is not guaranteed. Investments made can go down as well as up. Your Assigned Asset is part of the security provided to the bank to support the loan and reinvestment made by the Program. As such, you may not get back the full value of your Assigned Asset on exit from the Program. This document summarises aspects of, and is not a substitute for, the Offering Document. Neither the Company nor the Program is subject to any form of regulation or approval in the Isle of Man and participants are not protected by any statutory compensation arrangements in the event of the Company's failure. The Isle of Man Government Financial Supervision Commission does not vouch for the financial soundness of the Company or for the correctness of any statements made or opinions expressed with regard to the Company or the Program. The Program constitutes a "legacy experienced investor fund" and complies with the requirements of the Financial Supervision (Experienced Investor Fund) (Exemption) Order 1999 of the Isle of Man.



the Program, following finalisation of the lending and securitisation arrangements, will allow us to invest in a broad range of assets, thereby diluting the effect of the Arch Funds on the performance of the Portfolio. It is also worth remembering that the Foundations Program invests on a 5 year rolling return basis and as such, the Arch Funds are to be seen as a long term investment and therefore less significant in terms of short term volatility.

#### **Change to “Legacy Experienced Investor Fund”**

In line with recent changes in Isle of Man regulatory rules, the Foundations Program has changed its designation to that of Legacy Experienced Investor Fund (LEIF). This designation is similar to the previous designation, but there are a couple of significant changes to be aware of. Firstly, the minimum value for an asset to be assigned to the Program has risen from USD65,000 to USD100,000 and secondly, prospective investors will need to declare their net wealth to be a minimum of USD1m, not including what they report as their primary residence. However, there are a range of exemptions to this included in the application form, which effectively exclude those who are in the financial industry or who are suitably familiar with investments and, specifically, the investment decision they are taking.

These changes bring the Program in to line with all other LEIF funds

#### **Looking ahead**

As soon as the new lending and securitisation arrangements are finalised, we shall be increasing the Program loan substantially and buying into a wide range of asset classes that will generate positive returns and increase diversification within the Portfolio. Together with opportunities already identified by the Investment Committee, the next 6 months looks positive for growth.

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