

## **Item 1 – Cover Page**

Paloma Partners Management Company

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This Brochure provides information about the qualifications and business practices of Paloma Partners Management Company (“PPMC”). If you have any questions about the contents of this Brochure, please contact us at (203) 861-8405. The information in this Brochure has not been approved or verified by the SEC or by any state securities authority.

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

This Brochure does not constitute an offer to sell or a solicitation of any offer to invest in any security. All descriptions of the Funds in this Brochure, including, but not limited to, their investments, the strategies, fees and other costs associated with an investment in the Funds, and any conflicts of interest faced by PPMC in connection with management of the Funds are qualified in their entirety by reference to the Funds’ offering documents.

## **Item 2 – Material Changes and General Information**

This update does not contain any material changes from the previous brochure.

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Defined Terms:

*PPMC:* Paloma Partners Management Company

*TAM:* Trust Asset Management, LLP

*Paloma Management:* PPMC and TAM are collectively referred to as Paloma Management.

*Feeder Funds:* Private funds that invest substantially all of their capital in the Master Fund. There is currently one onshore and one offshore feeder fund investing in the Master Fund.

*The Fund:* The Fund is a master-feeder fund. The Feeder Funds, the Master Fund and the entities through which Portfolio Managers execute their strategies are collectively referred to as the Fund or Funds.

*Trading Team:* Trading Teams are engaged by the Fund as independent contractors and are given trading discretion on behalf of the Fund to pursue investment strategies authorized by Paloma Management.

*Portfolio Fund:* Portfolio Funds are external investment funds managed by an investment manager other than PPMC (whether or not affiliated with PPMC) in which the Funds invest.

*Portfolio Managers:* Trading Teams and Portfolio Funds may be collectively referred to as Portfolio Managers

#### **Item 4 – Advisory Business**

PPMC is a Delaware corporation and has its principal place of business in Greenwich, Connecticut. S. Donald Sussman, PPMC's founder and Chairman, has been managing hedge fund investments since 1981 and established PPMC in 1989 to facilitate the operations of funds advised by Mr. Sussman. Mr. Sussman currently provides advisory services to the Fund through TAM, a separately registered investment adviser (SEC File No. 74171).

PPMC is owned equally by Mr. Sussman and certain senior employees of PPMC (Philip Anker, Michael Berner, Heather Garson, Gregory Hayt, Gavin Morrocu and Randall Tam).

In addition to facilitating the operations of the Funds, PPMC also provides discretionary investment advisory services to the Funds separate and apart from TAM, but subject to TAM's ultimate authority. PPMC's exercise of discretion with respect to the Funds is typically in furtherance of the Funds' investment program as determined by TAM.

PPMC's advisory services include:

- due diligence on as well as sourcing and monitoring of Portfolio Managers;
- re-allocation of capital among Portfolio Managers;
- trading; and
- hedging the Fund's exposures.

PPMC also provides other non-advisory services to the Fund's, such as:

- risk management;
- selecting, approving and monitoring the Fund's custodians, prime brokers and counterparties;
- documentation services;
- information technology;
- investor relations;
- middle and back office-related services;
- tax related services; and
- compliance services.

All such services, are provided to, and for the benefit of, the Fund, PPMC and/or TAM (and not for the benefit of the Trading Teams).

#### **The Funds**

The Fund's investment objective is to achieve attractive long-term risk-adjusted returns with low correlation to major market indices through a dynamic and changing set of investment strategies. In

general, Paloma Management seeks to allocate the Fund's capital among a diverse group of Trading Teams and Portfolio Funds. The investment activities and performance of Portfolio Managers are monitored by Paloma Management.

Paloma Management is responsible for managing the Fund in accordance with its investment objectives which are broadly described in the Fund's offering documents. Paloma Management has overall responsibility for the Fund's investment activities and retains investment discretion with respect to the Funds' assets. Paloma Management currently directly manages a small portion of the Fund's assets (and may in the future manage a greater portion of the Fund's assets), however, most of the Fund's assets are managed in the name of the Master Fund on a discretionary basis by Trading Teams. The Fund also makes some opportunistic investments in Portfolio Funds.

Trading Teams generally have discretion with respect to their trading mandate, which may be modified from time-to-time and is subject to Paloma Management's general direction concerning matters of risk and strategy. Paloma Management has position-level information about, and ultimate management control over the Fund and the investments made by Trading Teams on a T+1 basis through PPMC's risk management system; however, Paloma Management does not supervise or control the general management aspects of Trading Teams.

PPMC's risk management and credit systems are employed to monitor and support the investment activities of the Trading Teams. In addition to facilitating the risk management process, the transparency and liquidity afforded by the Fund's structure allows Paloma Management to dynamically re-allocate capital among Trading Teams and strategies as market opportunities and conditions change while centralizing the management of the Fund's operations and controls under PPMC.

The day-to-day activities of Portfolio Funds are generally external to the risk management and organizational control of Paloma Management. However, Paloma Management regularly reviews performance and strategy information provided by Portfolio Funds.

As of March 30, 2012, PPMC managed \$1.8 billion of capital on a discretionary basis.

## **Item 5 – Fees and Compensation**

PPMC does not have a fee schedule.

PPMC does not receive management fees or performance based compensation from the Fund, however, certain employees executing or overseeing investment strategies for the Fund may receive performance based compensation. All expenses incurred by PPMC in connection with the operation of the Funds, (including, without limitation, expenses such as salaries and bonuses paid to PPMC employees and all other operating expenses of PPMC) are paid directly or indirectly by the Feeder Funds (and, therefore, by investors in the Feeder Funds). Expenses borne by the Fund, including PPMC's expenses, are deducted from the relevant Fund's assets periodically in advance or in arrears. Investors and prospective

investors should carefully review these operating costs and expenses, as set forth in the relevant Fund's Offering Documents.

Certain PPMC employees may be paid discretionary bonuses in connection with marketing activities on behalf of certain of the Funds. While such bonuses may consider sales of interests in the Funds, no direct commissions are paid to any such supervised persons.

The Feeder Funds will each bear all of their respective direct expenses, including their organizational, ongoing operating, administration, trading, offering, legal and audit expenses, and any other expenses of any nature related to the business of the Funds. The Feeder Funds will also bear the fees and expenses of any direct investment activities in which it engages and, through its investment in the Master Fund, will bear its *pro rata* share of the expenses related to the administration and investment activities of the Master Fund.

PPMC seeks to allocate its expenses equitably among the Funds in accordance with its expense allocation procedures. While PPMC believes its methodologies are reasonable, reasonable alternative methodologies may exist which could yield different results. Expenses allocated to the Funds are material, both on an absolute basis and as a percentage of the Funds' assets.

*TAM Management Fee:* TAM generally receives a management fee, monthly in arrears, from each Feeder Fund equal to 1/12 of 1.5% (1.5% annualized) of each investor's capital account balance or net asset value, as applicable.

The Funds are also currently invested in a Portfolio Fund from which Mr. Sussman receives a portion of the performance based compensation payable to the Portfolio Fund's manager.

The Funds, with the consent of TAM, may elect to reduce, waive, calculate differently, or provide rebates on:

- the management fee with respect to certain investors, including, without limitation, investors that are partners, affiliates or employees of Paloma Management, members of the immediate families of those persons and trusts or other entities for their benefit, strategic or large investors or in connection with solicitation arrangements with placement agents and asset aggregators; and
- any Liquidity Capital Account Reduction (defined below) with respect to certain investors, including, without limitation, strategic or large investors or in connection with solicitation arrangements with placement agents and asset aggregators (but not investors that are partners, affiliates or employees of Paloma Management, members of the immediate families of those persons and trusts or other entities for their benefit).

The Fund's expenses, including PPMC's expenses, cannot be waived, reduced, calculated differently or rebated for any investor.

Investors in the Fund that elect a quarterly withdrawal cycle (instead of an annual withdrawal cycle) are subject to a Liquidity Capital Account Reduction<sup>1</sup> at an annual rate of either 0.25% or 0.50% of the relevant capital account balance (depending on the value of the capital account balance). Any Liquidity Capital Account Reduction will be credited to the capital account balances of investors electing an annual withdrawal cycle on a *pro rata* basis; *provided* that any amount over and above the sum of (i) the TAM management fee and (ii) the Fund's administration and operating expenses (but not trading expenses) (each of (i) and (ii) as allocated to or otherwise borne by investors electing an annual withdrawal cycle in the aggregate) are payable to TAM.

*Reserves:* If, after giving effect to a withdrawal, an investor would be completely withdrawn from the relevant Fund except for its interest in one or more illiquid investments, TAM may determine to reserve or hold back a portion of the proceeds with respect to such withdrawal that is required, in its reasonable discretion, to pay for the management fee then expected to be earned (or owed, as applicable) and other expenses, liabilities and contingencies then expected to be accrued over the life of those illiquid investments (including general reserves for unspecified contingencies).

*Portfolio Manager Compensation:* Portfolio Managers are typically entitled to receive a management fee and performance-based compensation calculated in accordance with the relevant investment management agreement. Management fees paid to a Trading Team are generally determined through negotiations with Paloma Management. Performance-based compensation is generally calculated based on a percentage of the Portfolio Manager's net profits as of each calendar year-end or as of the date of a Portfolio Manager's termination. Performance-based compensation may be subject to a hurdle rate and/or a high water mark, and may, but on average does not, exceed 20% of the relevant net profits. A high water mark may be waived if Paloma Management deems the waiver to be in the best interest of the Fund. The Fund may also provide Trading Teams with advances, which may be non-refundable, on their performance-based compensation. Performance-based compensation is generally payable to each Portfolio Manager based solely on its own performance. The Fund may therefore pay performance-based compensation to a Portfolio Manager even if the overall performance of the Funds is negative.

The Fund's investment in a Portfolio Fund, will be subject to that fund's asset-based and performance-based compensation as well as a share of that fund's expenses.

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<sup>1</sup> Investors in the Offshore Feeder Fund are subject to a Liquidity NAV Reduction, which reduces the net asset value of shareholders with a quarterly redemption cycle at the same rate as the Liquidity Capital Account Reduction reduces investors' capital account balances.



## **Item 6 – Performance-Based Fees and Side-By-Side Management**

As described in Item 5 above, Portfolio Managers generally receive performance-based compensation from the Funds. Although certain PPMC employees may, PPMC does not receive any performance-based compensation from the Funds.

The receipt of performance-based compensation may incentivize Portfolio Managers to make investments that are riskier or more speculative than they would make if they did not receive performance-based compensation. Further, “net appreciation,” which is the basis for most performance-based compensation, includes unrealized appreciation of client assets, and may result in that person receiving greater performance-based compensation than would be the case if net appreciation was based only on realized gains. Because Paloma Management is independent from the Portfolio Managers, PPMC’s employees responsible for risk management are not paid performance-based compensation and are therefore not incentivized to permit riskier or more speculative investments. Furthermore, Paloma Management has a significant investment in the Fund, thus aligning its interests with investors in ensuring the Fund does not suffer losses as a result of risk taking by Portfolio Managers.

Portfolio Managers may be incentivized to favor a client that pays performance-based compensation over a client that does not pay, or pays lower, performance-based compensation. For example, Portfolio Managers may be incentivized to allocate more profitable assets (or dedicate a greater portion of their time) to clients that pay higher performance-based compensation than the Funds. PPMC expects that the Portfolio Managers maintain policies and procedures that seek fair allocation of time and investment opportunities among all clients.

Performance-based compensation may encourage Portfolio Managers to overvalue assets in order to increase the amount of that performance-based compensation. To mitigate this conflict in the context of the Trading Teams, J.P. Morgan values, and, PPMC in consultation with TAM ultimately determines the value of the Funds’ assets.

## **Item 7 – Types of Clients**

PPMC provides discretionary portfolio management services to the Funds (which may be organized as domestic or foreign partnerships, corporate or other incorporated or unincorporated entities).

Interests in the Funds and the Funds themselves are not registered under the U.S. Securities Act of 1933, as amended or the Investment Company Act of 1940, as amended, respectively. Accordingly, interests in the PPMC Funds are offered exclusively to investors satisfying the applicable eligibility and suitability requirements either in private placement transactions within the United States or in offshore transactions, and the Funds are excepted from the definition of an “investment company” under Section 3(c)(7) of the Investment Company Act of 1940, as amended.

The minimum initial investment is generally \$10 million. However, the Funds may accept contributions of a lesser amount in compliance with applicable law.

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

*The information included in this Brochure does not include every potential risk associated with each investment strategy or security. Investors and prospective investors should review the Fund's offering documents for a complete description of potential risks. An investment in the Fund is speculative and may involve a high degree of risk which could result in a loss of all, or substantially all of an investor's capital.*

The Funds do not impose diversification requirements or material limitations on the investment strategies, instruments, markets or countries in which the Funds may invest.

The following is a summary of (i) the strategies and methods Paloma Management and/or the Portfolio Managers use in formulating advice or managing assets (and their material risks) for the Funds and (ii) certain material risks associated with the types of securities relevant to these strategies.

### **STRATEGIES AND CERTAIN RELATED RISKS**

*Credit and Equity Relative Value/Arbitrage:* This strategy focuses on extracting value by investing in different portions of the entire capital structure, ranging from debt to equity, of one or more companies. This type of trading involves determining whether different types of securities are mispriced relative to one another or are underpriced or overpriced relative to some measure of intrinsic worth. Positions may also include related hedges involving the utilization of credit default swaps, options, and other financial instruments. The overall portfolio can range from being market neutral to having significant directional exposure.

One sub-set of this strategy is convertible security arbitrage, which involves buying a bond or preferred stock that is convertible into the common stock of the same or a different issuer and simultaneously selling short the underlying common stock, either directly or through the use of options.

*Risks:* Perceived pricing inefficiencies underlying an issuer's securities may fail to materialize. The securities may turn out to have no relationship.

*Distressed Securities:* This strategy involves buying the securities of companies involved in spin-offs, bankruptcies, liquidations, workouts, financial reorganizations, operational turnarounds or other similar events in anticipation that those securities will appreciate. This strategy involves, at times, purchasing bank debt related to the issuer and may also involve selling short the relevant securities for hedging or investment purposes. Portfolio Managers may also focus on companies with significant real estate assets and invest in securities backed by, or closely related to, the underlying real estate assets of the

issuer. In addition, Distressed Investing may encompass investments in the obligations of sovereigns, government agencies, or municipal securities, among other possible investments.

*Risks:* Issuers of “below investment grade” securities and obligations may be: (i) in weak financial condition; (ii) experiencing poor operating results; (iii) having substantial capital needs or negative net worth; (iv) facing special competitive or product obsolescence problems (including companies involved in bankruptcy or other reorganization and liquidation proceedings). It may be difficult to obtain information as to the true condition of distressed issuers. Laws relating to, among other things, fraudulent transfers and other voidable transfers or payments, lender liability and the bankruptcy court’s power to disallow, reduce, subordinate or disenfranchise particular claims, may adversely affect these investments.

*Equity Long/Short:* This strategy involves taking positions in the equity securities of companies based on an assessment of fundamental value of those companies compared to market prices. The Fund may take a long position in securities that it considers undervalued and sell short securities that it considers overpriced. Portfolio structures can range from market neutral to having some correlation to general market movements. The strategy may also involve taking long or short positions in specific securities versus an index, exchange traded fund, or basket of securities. The overall portfolio aims to modulate correlation to major market directional movements.

*Risks:* Short securities’ positions are speculative and more risky than “long” positions (purchases) because the cost of the replacement security is unknown. The potential loss on an uncovered short sale is unlimited. Prices of stocks can fall rapidly in response to developments affecting a specific company or industry, or to changing economic, political or market conditions.

*Event Driven:* This strategy involves investing in the securities of publicly-traded companies surrounding events including, but not limited to, corporate restructurings, dividend announcements, mergers, cash tender offers, exchange offers, acquisitions, spin-offs, recapitalizations and corporate governance situations, in expectation of profiting from the difference between the price of such securities at the inception of the investment and the price of such securities in expectation of, or upon, consummation of the event. In mergers and acquisitions, the portfolio manager frequently will simultaneously purchase the security of the company being acquired and sell short the security of the acquiring company. The portfolio may contain value-driven long or short positions in listed or unlisted equities, convertible bonds, and other securities.

One subset of this strategy is activist investing, which generally involves taking an ownership stake substantial enough, alone or in conjunction with others, to influence the management of the companies within a portfolio. A Portfolio Manager may build a cooperative relationship with management or may pursue hostile strategies. This strategy may include going-private transactions, management changes, divestitures, and acquisitions.

*Risks:* Event driven investing requires predictions about (i) the likelihood that an event will occur and (ii) the impact such event will have on the value of a company's securities. If the event fails to occur or it does not have the effect foreseen, losses can result. Control positions in an issuer's securities may subject the Fund to additional risks of liability for environmental damage, product defects, failure to supervise management, violation of governmental regulations and other types of liability in which the limited liability characteristic of business operations may be ignored.

*Fixed Income Relative-Value/Arbitrage:* This strategy involves the purchase and sale of fixed-income securities and related derivatives in order to capture inefficiencies in the relative pricing of similar fixed-income instruments. Typically, inefficiencies occur when supply-and-demand issues or other factors affect bonds at specific maturities along the yield-curve and a portfolio manager can buy or sell the inefficiently priced security and hedge the risk with securities of similar maturities. This type of relative-value trading involves the use of sovereign debt, interest-rate swaps, futures contracts, forward contracts, government-sponsored enterprise debt (i.e. "agency" securities) and options on all the aforementioned securities. Fixed-income relative value trading in agency and non-agency residential mortgage-backed securities, commercial mortgage-backed securities, and asset-backed securities and options may also be undertaken. At times of significant market dislocations, this strategy may involve taking significant directional, unhedged positions in certain securities.

*Risks:* Evaluating credit risk for debt securities involves uncertainty. The market for credit spreads may be inefficient and illiquid, making it difficult to accurately calculate discounting spreads for valuing financial instruments. An economic downturn could adversely affect the ability of the issuers of debt securities to repay principal and pay interest thereon and increase the incidence of default for such securities.

*High Yield Relative Value/Arbitrage:* This strategy involves buying and selling the debt of unrated companies or companies with ratings below investment grade. Positions both long and short are generally established based on an assessment of fundamental value. This strategy may employ credit derivatives, bank debt, senior and subordinated bonds, equity or other securities.

*Risks:* A major economic downturn could adversely affect the ability of the issuers to repay principal and pay interest thereon and increase the incidence of default of such securities. Higher-yielding debt securities are generally unsecured and may be subordinated to certain other outstanding securities and obligations of the issuer, which may be secured on substantially all of the issuer's assets.

*Statistical Arbitrage/Algorithmic Trading:* This strategy involves algorithmic process-driven trading in which the investing is driven by quantitative methods and statistical models. These models generate trading decisions by identifying mispricings based on different metrics such as deviations from equilibria, momentum, pattern recognition, volume, or flow-driven momentum effects and factors underlying security price variations. The frequency of trading varies by model, but may be high. These portfolios

have low outright market exposures and the objective is to generate returns with minimal correlation to directional moves of the major markets.

*Risks:* Perceived mispricings may fail to normalize as expected. The liquidation of portfolios at times of stress may result in losses. Quantitative models may be ineffective or may contain human or electronic errors (in coding, inputs or otherwise) that are either not discovered by or not disclosed by the Portfolio Managers.

*Systematic Futures Trading:* This strategy involves investing in a portfolio of futures contracts, including financial futures, equity indices, currencies and commodities contracts, using algorithmic or discretionary techniques in markets. Individual positions may have some directional exposure.

*Risks:* The prices of futures are highly volatile, and price movements of futures contracts can be influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and national and international political and economic events and policies.

*Volatility and Correlation Relative-Value/Arbitrage:* This strategy involves the purchase and sale of derivatives (typically instruments in which optionality plays a role) that are mispriced relative to their theoretical value. These strategies can also involve the purchase or sale of derivatives that are hedged by the simultaneous purchase or sale of the underlying security or financial contract.

*Risks:* In the event that the perceived volatilities underlying an issuer's securities were to fail to materialize as expected, the Funds could incur a loss. The Fund may have significant directional exposure to the volatility of one or more assets or the correlation of two or more assets.

*Macro Economic Strategies:* This strategy involves the purchase or sale of securities or derivatives for the purpose of profiting from price movements in equity market indices, bond prices, currencies, commodities, and other markets based, typically, on a macro-economic or broader economic analysis than would be applied to the purchase or sale of specific securities issued by corporations or governments. These strategies may be directional or seek to exploit the relative mispricing across markets and geographies.

*Risks:* Macro-economic based strategies depend on successfully exploiting larger economic themes in highly liquid markets such as equity indices, bond futures, currencies, and commodities. These markets have the potential to adjust extremely quickly to new information and, as such, the Funds may not be able exit a losing position until such adjustments have fully occurred, thus incurring a substantial loss. These strategies also typically employ significant leverage which has the potential to magnify gains and losses.

*Leverage:* This strategy involves the use of various financial instruments or borrowed capital, such as margin, to increase the potential return of an investment. The Funds may pledge securities in order to

borrow additional funds for investment purposes. A Fund may also leverage its investment return with options, short sales, swaps, forwards and other derivative instruments.

*Risks:* While leverage presents opportunities for increasing a portfolio's total return, it has the effect of potentially increasing losses as well. Accordingly, any event which adversely affects the value of a Fund's investment would be magnified to the extent the Fund is leveraged. This may result in a substantial loss to the Fund and its investors, which would be greater than if leverage had not been employed in managing the account.

*Hedging:* This strategy seeks to offset the risks associated with an individual position, the markets, a portfolio strategy or any other risks identified which the Portfolio Manager believes can be hedged. Hedging employs various techniques but, generally involves taking equal and opposite positions in two different markets (such as cash and futures markets).

*Risks:* There can be no assurance that such hedging techniques will be effective or that they will result in higher or more stable returns than would have been the case had they not been employed. Under certain circumstances, hedging techniques intended to reduce certain forms of risk may actually increase risk, whether due to the unintended market impact of hedging transactions, leverage effects associated with hedging positions, unexpected adverse price movements of a hedging instrument relative to the hedged instrument (i.e., adverse changes in the "basis" between the hedging and hedged instrument), lower liquidity of the hedged and hedging positions relative to an unhedged position, the risks related to the use of derivative instruments, or other factors.

*Investments in Private Companies/Private Equity:* This strategy encompasses a broad range of medium- and long-term investments in private companies that are not freely tradable on a public stock market and may be subject to significant restrictions on transfer and be otherwise illiquid. The Funds may also invest in mezzanine debt or other types of financing to private companies in connection with acquisitions or similar transactions. The Funds seek to profit from a successful disposition of these investments either in a "going public" transaction or in a private sale of the Funds' interest.

*Risks:* See "Investments in Private Companies/Private Equity; Related Risks" below in "TYPES OF SECURITIES AND CERTAIN RELATED RISKS."

*Investments in Real Assets:* This strategy involves opportunistic investing in physical, tangible assets which may include, without limitation, commodities, equipment, natural resources and property.

*Risks:* These investments may require a longer holding period as well as related transactions to unlock value. There may be a lack of a transparent pricing mechanism for these assets.

*Commodities Relative Value:* This strategy involves using both technical and fundamental analysis to invest in commodities or futures, options or derivatives in relation to commodities, including agricultural

products, energy products, metals and minerals, among others, utilizing both technical and fundamental analysis of relevant markets. The Fund may invest in the equity of companies that produce, process, convert, transport and service commodities, such as agricultural products, energy products, metals and minerals.

*Risks:* The prices of commodities contracts and derivative instruments, including futures and options, are highly volatile. Swaps and certain options and other custom instruments are subject to the risk of non-performance by the swap counterparty, including risks relating to the creditworthiness of the swap counterparty, market risk, liquidity risk and operations risk.

#### TYPES OF SECURITIES AND CERTAIN RELATED RISKS

*Common and Preferred Stock:* Equity securities fluctuate in value in response to many factors, including the activities and financial conditions of individual companies, the business market in which individual companies compete, industry market conditions and general economic environments.

*Debt Securities:* Debt securities, including convertible debt securities, may be subject to price volatility due to various factors including changes in interest rates, market perception of the creditworthiness of the issuer and general market liquidity. In addition to the sensitivity of debt securities to overall interest rate movements, debt securities involve a fundamental credit risk based on the issuer's ability to make principal and interest payments on the debt it issues.

*Government Securities:* A decline in interest rates will cause these investments' yields to decline and an increase in interest rates will cause these investments' prices to decline.

*Currencies:* The Fund's assets may be invested in non-U.S. securities and any income or capital received by the Fund will be denominated in the local currency of investment. Accordingly, changes in currency exchange rates (to the extent unhedged) will affect the value of the Fund's portfolio and the unrealized appreciation or depreciation of investments.

*High-yield Securities:* High-yield securities: (1) are generally not exchange traded and, as a result, these instruments trade in the over-the-counter marketplace, which is less transparent than the exchange-traded marketplace; and (2) face ongoing uncertainties and exposure to adverse business, financial or economic conditions which could lead to the issuer's inability to meet timely interest and principal payments.

*Options:* The writing or purchasing of an option runs the risk of losing the entire investment in such option or of causing significant losses to a Fund in a relatively short period of time. Buying and selling put and call options can result in large amounts of leverage. As a result, the leverage offered by trading in options could cause the Fund's asset value to be subject to more frequent and wider fluctuations than would be the case if the Fund did not invest in options.

A decrease (or inadequate increase) in the price of the underlying security in the case of a call, or an increase (or inadequate decrease) in the price of the underlying security in the case of a put, could result in a total loss of investment in the option. The seller of an uncovered call option bears the risk of an increase in the market price of the underlying security above the exercise price. The risk is theoretically unlimited unless the option is “covered.”

*Futures:* The prices of futures are highly volatile, and price movements of futures contracts can be influenced by, among other things, interest rates, changing supply and demand relationships, trade, fiscal, monetary and exchange control programs and policies of governments, and national and international political and economic events and policies.

*Swaps/Other Derivatives:* Swaps and certain options and other custom instruments are subject to the risk of non-performance by the swap counterparty, including risks relating to the creditworthiness of the swap counterparty, market risk, liquidity risk and operations risk.

*Credit Default Swaps:* Credit default swaps involve the risk of an unlimited increase in the market price of a particular security.

*Securities of Non-U.S. Companies:* Investments in securities of non-U.S. issuers or securities denominated or whose prices are quoted in non-U.S. currencies pose, to the extent not hedged, currency exchange risks (including blockage, devaluation and non-exchangeability), as well as a range of other potential risks which could include expropriation, confiscatory taxation, imposition of withholding or other taxes on dividends, interest, capital gains or other income, political or social instability, illiquidity, price volatility and market manipulation.

Less information may be available regarding securities of non-U.S. issuers, and non-U.S. issuers may not be subject to accounting, auditing and financial reporting standards and requirements comparable to, or as uniform as, those of U.S. issuers. There is generally less government supervision and regulation of exchanges, brokers and issuers than there is in the United States.

*Repurchase Agreements:* Repurchase agreements involve credit risk to the extent that a Fund’s counterparties avoid certain obligations in bankruptcy or insolvency proceedings, which would likely expose the Fund to unanticipated losses.

*Investments in Developing and Emerging Markets:* Developing or emerging markets may be more likely than developed markets to experience periods of illiquidity, market disruptions, political instability, economic distress, social instability, rules changes and restrictions on capital movement.

*Investments in Private Companies/Private Equity:* A Fund may invest in private companies at an early stage of development, which involves a high degree of business and financial risk. Early-stage companies with little or no operating history may require substantial additional capital to support expansion or to



achieve or maintain a competitive position, may produce substantial variations in operating results from period to period or may operate at a loss.

## PORTFOLIO FUND INVESTMENTS

In addition to the risks associated with the strategies and instruments utilized by Paloma Management and/or the Portfolio Managers, the Fund's investments in Portfolio Funds present additional risks to investors. These additional risks include, without limitation:

*Liquidity Risk:* Investments in Portfolio Funds may be subject to liquidity constraints (for example, lock-up periods, notice requirements, suspension of withdrawal provisions, gates (which would generally limit the amount of withdrawals if withdrawal requests exceed a specified percentage of the Portfolio Fund's net asset value) and/or side pocket provisions (which would generally prevent the Funds from making withdrawals from a Portfolio Fund in respect of investments deemed by the Portfolio Manager to be "illiquid" until the Portfolio Manager determines that those investments are no longer illiquid or liquidates those investments)).

*Lack of Transparency:* Paloma Management may have limited information about the actual securities held by a Portfolio Fund at any given time.

*Fraud or Mismanagement:* The Portfolio Manager, the administrator of the Portfolio Funds (or any other person with access to the Portfolio Fund's assets) could divert or abscond with Fund assets, fail to follow the disclosed investment strategy, provide false reports of operations or engage in other fraud or misconduct.

*Valuation Risk:* Paloma Management will have little or no means of independently verifying valuations provided by the Portfolio Fund.

*Risk of multiple levels of fees and expenses:* Through a Fund's investment in a Portfolio Fund, the Funds' investors bears expenses and asset-based fees at the Fund level, in addition to any expenses, asset-based and performance-based fees and allocations at the Portfolio Fund level.

## Item 9 – Disciplinary Information

On September 2, 1997, S. Donald Sussman settled a claim (regarding alleged violations of the Advisers Act) with the SEC and paid a \$40,000 civil monetary penalty. The SEC's order (Advisers Act Release No. 1653) is available here: <http://www.sec.gov/litigation/admin/ia1653.txt>.

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

In addition to providing investment advice and other services to the Funds, TAM also provides services to other private investment funds and investment managers. TAM is currently registered with the CFTC as a commodity pool operator. Mr. Sussman is currently registered with the CFTC as an “associated person” of TAM.

*China Managers*<sup>2</sup>: The China Managers, in which Mr. Sussman holds an interest directly and indirectly (including through TAM), manage private equity funds in which one or more of the Funds currently invest. Because of the affiliation between PPMC and the China Managers, there may appear to be a conflict between PPMC’s fiduciary duty to the Funds and the benefits accruing to S. Donald Sussman (for example, greater fees earned through his interest in the China Managers) as a result of the Funds’ investment in the China Funds. PPMC believes that its allocation procedures help to mitigate this potential conflict (see Item 11 for a description of PPMC’s allocation procedures).

*Pacific Alternative Asset Management Co LLC*: Through his ownership of Franklin Realty Company, Mr. Sussman indirectly owns 40% of PAAMCO Founders Co., LLC which owns 76.25% of Pacific Alternative Asset Management Co LLC, a registered investment adviser, commodity pool operator and commodity trading advisor. Mr. Sussman is registered with the CFTC as an “associated person” of Pacific Alternative Asset Management Co LLC. Mr. Sussman does not currently participate in the management of Pacific Alternative Asset Management Co LLC.

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

*PPMC’s Code of Ethics*: The PPMC Code of Ethics provides a standard of conduct for, among other things, the personal trading of PPMC employees. Under the Code of Ethics, PPMC employees must provide PPMC with initial and annual holdings reports (excluding accounts holding certain securities or discretionary accounts) and quarterly transactions reports. PPMC employees are also generally prohibited from participating in initial public offerings and executing transactions in issuers included on PPMC’s Personal Securities Trading Restricted List, and must obtain preapproval from PPMC’s Chief Compliance Officer prior to investing in any private placement. PPMC will review violations of its Code of Ethics to determine appropriate internal sanctions.

Investors in the Funds may obtain a complete copy of PPMC’s Code of Ethics free of charge by submitting a written request to PPMC’s Chief Compliance Officer at 2 American Lane, Greenwich CT 06831 or by phone at (203) 861-8405.

*Other Potential Conflicts*: Paloma Management and/or the Funds’ Portfolio Managers (collectively “Investment Persons”) may engage directly or indirectly in any business or other activities, including

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<sup>2</sup> New China Investment Management, Inc., New China Capital Management, LP and Cathay Master GP, Ltd.

exercising investment advisory and management responsibility and buying, selling or otherwise dealing with securities for their own accounts, for the accounts of family members, and for the accounts of individual and institutional clients. These activities may conflict with Investment Persons' activities on behalf of the Funds. For example:

- Investment Persons may individually or on behalf of clients invest in the same securities in which the Funds may invest or trade (or in the PPMC Funds themselves), and may invest the assets of the PPMC Funds in a security while withdrawing (or recommending the withdrawal of) the same investment held by the PPMC Funds; and
- Investment Persons may give advice and take action in the performance of their duties to one account which may differ from the timing and nature of action taken with respect to another account.

These other activities may affect the prices and availability of the securities and other financial instruments in which the Funds invest.

- Paloma Management has no obligation to purchase or sell for any account any investment which those persons may purchase or sell, or recommend for purchase or sale, for its or their own respective accounts, or for any other client account.

Investment Persons that have ownership interests in certain funds may have an incentive to favor those funds (and therefore themselves) over the Funds. For example:

- Certain Investment Persons do own and may in the future acquire additional interests in certain of their clients (including the Funds).
- An Investment Person (or its affiliate) may provide most of the initial seed money for a new fund (in which case that fund may be wholly or principally owned by that Investment Person (or its affiliate)).

PPMC has in place various policies and procedures to ensure that the Funds are treated fairly and that PPMC acts in the best interests of the Funds (see, for example, PPMC's allocation procedures, as described below).

*Allocation Policy:* Because most of the Funds' assets are currently managed by Portfolio Managers, most allocation decisions with respect to the trading of assets occur at the Portfolio Manager level. PPMC expects that these Portfolio Managers will each have their own allocation procedures.

Nevertheless, PPMC has its own allocation policies in place to be utilized in those instances where it needs to make allocation decisions. Its policies are designed to promote the fair and equitable

allocation and execution of investment opportunities among the Funds over time and are designed to comply with the securities laws and other applicable regulations.

While most of the Funds' investments are made through the Master Fund in limited instances, PPMC may cause the Feeder Funds to instead invest directly in the same or similar instrument. Such investments may be made on a basis that is other than on parallel terms or a *pro rata* basis, in the discretion of Paloma Management, when deemed: (i) appropriate given the differences between the funds and involved; and/or (ii) otherwise to be in the best interests of the funds and accounts involved.

The Funds' master-feeder structure may create a conflict of interest in that different tax considerations for the Master Fund and the Feeder Funds may cause the Master Fund to structure or dispose of an investment in a manner that provides more advantageous tax treatment, or better (or worse) returns, to one or more Feeder Funds than to the other Feeder Funds. Additionally, a Feeder Fund may trade and invest part of its capital for its own account, when presented with investment opportunities appropriate for it and its investors but that are not appropriate or not optimal (for tax or other reasons) for direct or indirect investors in the Master Fund.

*Letters of Understanding a/k/a "Side Letters":* By entering into side letters, certain investors in the Funds may receive information that is not generally available to, or utilized by, other Fund investors (whether with respect to the relevant Fund, the financial markets generally or otherwise) and, as a result, may be able to act on such information (i.e., request redemptions) when others cannot. Paloma Management seeks to mitigate the potential conflicts arising from such requests by offering the opportunity to access such information to all investors in the Funds' Documentation.

*Any or all of the potential conflicts of interest set forth below could apply to Paloma Management or the Portfolio Managers (collectively "Investment Persons").*

*General Conflicts:* Investment Persons may have multiple advisory, transactional, financial and other interests in securities, instruments, companies or investment vehicles that may be purchased or sold for the Funds. PPMC has established a variety of procedures and disclosures designed to address conflicts of interest arising between the Funds on the one hand and PPMC's business on the other.

*Affiliated Investments, Cross Trades and Principal Trades:* Investment Persons may act in multiple capacities (for example, acting as principal or agent in addition to advising a client), and may effect transactions with or for an account in instances in which Investment Persons may have multiple interests. PPMC has and may in the future invest assets of the PPMC Funds in entities managed by its affiliates.

*Additional Compensation:* Investment Persons may receive asset and/or performance-based compensation (as well as reimbursement of certain expenses and indemnification guarantees) in respect of investments by the Fund in entities managed by Investment Persons. The determination by Paloma Management to effect any such investment for the Funds will be based on such criteria as Paloma

Management may determine to be appropriate at the time. Entities managed by Investment Persons in which such investments are made may charge higher fees and expenses than would be the case if such investment were made in a comparable, non-affiliated collective investment fund or vehicle. Paloma Management has no obligation to determine whether an investment in a comparable, non-affiliated collective investment fund or vehicle would subject the Funds to lower fees and expenses.

*PPMC may cause its clients to engage in cross trades:* PPMC does not currently, but may in the future, buy and sell the same security between its client accounts when it believes, in its sole discretion, that such a transaction would be advantageous or otherwise beneficial to each of the client account involved.

## **Item 12 – Brokerage Practices**

PPMC generally has the authority (as does TAM) to determine without client consultation or consent, the broker-dealer or other counterparty through which securities or other instruments (for purposes of this Item 12, the term “securities” includes such other instruments) are bought and sold, and the appropriate compensation for the execution of such transaction and the term “compensation” means, collectively, commission rates, mark-ups, mark-downs (and other transactional and non-transactional charges).

Because the majority of the Fund’s assets are currently managed by Portfolio Managers, most trading decisions are made at the Portfolio Manager level. However, PPMC reviews and approves the prime brokers, executing brokers-dealers and counterparties used by the Trading Teams. PPMC expects that each Portfolio Manager will seek to obtain best execution on an overall basis.

In placing orders for the purchase and sale of securities for clients, PPMC’s policy is to seek the best execution of orders on an overall basis, which means that it seeks to ensure that the client’s total cost or proceeds is the most favorable under the circumstances. Accordingly, transactions will not always be executed at the best price or the lowest available compensation. PPMC does not have any obligation to use execution-only brokers in effectuating transactions on behalf of its clients.

PPMC does not adhere to any rigid formulas in making its selection of broker-dealers to effectuate securities transactions, but weighs a combination of factors or criteria. For example, in selecting brokers to effect portfolio transactions, the determination of what is expected to result in best execution on an overall basis involves a number of factors, including: reliability, reputation, experience in the industry, financial stability, capital commitment, efficiency in executing and clearing transactions, confidentiality of trading activity, provision of Products and Services (that is, research and brokerage products and services), idea generation, competitive transaction costs, and general responsiveness.

Products and Services constituting “research” may be in any form (e.g., written, oral or on-line) and may include, without limitation: traditional research reports analyzing the performance of a particular company or stock, market, company and financial data; market, economic, political and financial

information (including studies and forecasts); statistical information; data on the pricing and availability of securities; and seminars and conferences relating to the investment in securities or containing analyses of issuers, industries, securities, economic factors and trends and portfolio strategy.

Products and Services constituting “brokerage” may include, without limitation, clearance services, settlement services, and custody services.

To the extent that PPMC acquires Products and Services through the use of “soft dollars,” Products and Services received will be of the type contemplated by Section 28(e) of the U.S. Securities Exchange Act of 1934 (that is, “research” and “brokerage”), although transactions may or may not otherwise comply with the provisions of Section 28(e) (e.g., may relate to transactions in instruments other than securities). By directing trades to particular broker-dealers, PPMC may generate “credits” (which may be redeemed for Products and Services provided by those broker-dealers).

The use of soft dollars may cause the Fund to effectively pay higher transaction costs than otherwise would be paid in the absence of a soft dollar arrangement. Products and Services may be used by PPMC for itself and/or in servicing the Fund. Further, the relationships with broker-dealers that provide “soft dollar” Products and Services to PPMC may influence its judgment in allocating brokerage business and create a conflict of interest in using the services of those broker-dealers to execute the Fund’s brokerage transactions.

It is expected that, in the conduct of their trading activities, the Portfolio Managers will be subject to similar conflicts of interest for themselves as are described above for PPMC in respect of their trading activities. It is expected that Portfolio Managers will have in place their own policies and procedures by which they will monitor their own compliance with their best execution obligations to the Funds.

In connection with soft dollar arrangements, the Trading Teams have been instructed, pursuant to their respective agreements with the Funds, to limit the types of products and services acquired by them by way of soft dollars to Products and Services of the type described above (*i.e.*, those delineated above to the extent that they constitute “research” or “brokerage” within the meaning of Section 28(e)), although the related trades may not necessarily comply with the provisions of Section 28(e).

In selecting broker-dealers for execution of securities transactions for the Funds, PPMC and/or its affiliates may also consider a broker’s assistance with arranging for representatives of PPMC and/or its affiliates to speak at Capital Introduction Events. Through such Capital Introduction Events, prospective investors have the opportunity to meet with representatives of PPMC and/or its affiliates. Currently, neither PPMC nor its affiliates compensate brokers for organizing such events or for any investments ultimately made by prospective investors attending such events (although any of them may do so in the future).

Certain of the Portfolio Managers may similarly participate in Capital Introduction Events. Such Portfolio Managers may gain access to Capital Introduction Events by virtue of their trading of the Fund’s

securities with the related broker-dealers, and thereby may be introduced to investors/clients with respect to investment products managed by them other than the Funds. As a result, such Portfolio Managers may have a conflict of interest in selecting broker-dealers for the execution of transactions for the Funds.

*Aggregation of Trades:* In the case that PPMC executes trades on behalf of both Feeder Funds or the Feeder Funds and the Master Fund, and if portfolio decisions are made contemporaneously for multiple Funds in the same instrument, PPMC may, if consistent with market conditions, Fund characteristics, and applicable law, bunch or aggregate client orders (including orders for clients in which Investment Personnel have beneficial interests) for execution. These bunched or aggregated orders might facilitate execution and may reduce brokerage and other costs. PPMC, however, is not required to bunch or aggregate orders if portfolio management decisions are not made contemporaneously, if PPMC determines that it would be consistent with its investment management duties or the interests of its clients not to do so, or if bunching or aggregating is not practical operationally or otherwise.

Although it is anticipated that any bunching or aggregation of orders will benefit each Fund overall, aggregating orders may disadvantage a Fund, including by resulting in shared allocations of orders or higher execution prices. Alternatively, not aggregating orders may disadvantage a Fund, including by resulting in higher costs (including higher execution prices). Portfolio Managers may have their own trade aggregation policies, which may or may not provide for the aggregation of client trades under certain circumstances.

*Trade Errors:* The Funds (and not Paloma Management or Portfolio Managers) will bear the cost of any losses (and reap the benefits of any gains) resulting from trading errors and similar human errors, absent gross negligence or reckless or intentional misconduct. Trading errors might include, for example, keystroke errors that occur when entering trades into an electronic trading system or typographical or drafting errors related to derivatives contracts or similar agreements. Given the volume of transactions executed on behalf of the Funds, investors should assume that trading errors (and similar errors) will occur and that the relevant Fund will be responsible for any resulting losses, even if such losses result from the negligence (but not gross negligence) of any “indemnified party.”

### **Item 13 – Review of Accounts**

Risk management analysis and reporting are the responsibilities of PPMC’s Chief Risk Officer and Risk Management Group.

Paloma Management believes careful management of risk is an important part of a successful investment program and has developed a proprietary Risk Management System that has functioned for many years as a key component of the Funds’ operations. PPMC monitors and analyzes the portfolio using its Risk Management System and other tools and then adjusts the Funds’ risk when appropriate based on PPMC’s expertise and judgment.

On a daily basis, the Risk Management System captures positions, terms and conditions of securities, pricing and market data, corporate actions as well as other position level details from the Funds' administrator. The portfolio is then evaluated using proprietary and commercially available pricing models resulting in a range of standard and proprietary risk measures.

As described in Item 4 above, Paloma Management generally has on-going, position-level information on the investments made by Trading Teams on a T+1 basis. Transparency and control over capital are important parts of the Funds' risk management process and the re-allocation of capital among Trading Teams and strategies as market opportunities and conditions change. Paloma Management does not typically have daily transparency, liquidity or control over investments in Portfolio Funds. Nevertheless, PPMC regularly reviews information provided by those funds, including performance and strategy disclosure.

As soon as reasonably practicable after the end of each fiscal year, the Funds will furnish (or cause to be furnished) annual financial statements audited by an independent public accounting firm to every person who was an investor in the relevant Fund at any time during that fiscal year. The Funds will also provide periodic unaudited performance information, no less frequently than quarterly, to their investors. The reports provided to investors in the Funds are written.

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

PPMC, TAM or the Funds may enter into arrangements with third parties whereby such third parties receive fees for introducing investors to the Funds. Any such compensation is paid by TAM and is only paid if the arrangement complies with applicable rules and regulations.

#### **Item 15 – Custody**

To the extent required by applicable law, securities and funds are held by qualified custodians. As noted in Item 13 above, Fund investors receive annual financial statements audited by an independent public accounting firm for the Fund(s) in which they have invested.

#### **Item 16 – Investment Discretion**

PPMC (as well as TAM) exercise discretion in managing each Fund, based on the Fund's investment objectives, policies and strategies disclosed in the relevant Fund's Offering Documents. PPMC typically assumes this authority through its agreements with the Funds. (See Item 4 for a description of this discretionary authority.)



## **Item 17 – Voting Client Securities**

As a general matter, PPMC and TAM do not vote proxies. The majority of the Fund's securities are purchased for trading and not investment purposes; the Fund is not typically a long term holder of securities and will therefore typically not be affected by matters being voted on.

Investors may not direct PPMC's vote on a particular proxy.

Pursuant to each Trading Team's investment management agreement, the Trading Team is generally granted the discretion to vote any proxies related to the Fund assets managed by that Trading Team. PPMC expects that each Portfolio Manager generally will have its own proxy voting policies, which, at a minimum, will require that the Trading Team vote proxies in the best interests of its clients (if such proxies are voted at all).

Investors in the PPMC Funds may obtain a complete copy of PPMC's Proxy Voting Policy and Procedures or information on how PPMC voted proxies for the relevant PPMC Fund free of charge by submitting a written request to PPMC's Chief Compliance Officer at 2 American Lane, Greenwich CT 06831 or by phone at (203) 861-8405.

## **Item 18 – Financial Information**

At this time, PPMC has no information to report that is applicable to this Item 18.

## Privacy Statement

The following privacy statement applies to Paloma Partners Management Company (“**we**”) for current and former natural person limited partners in our funds (“**you**”).

*Our Commitment to Your Privacy:* we are sensitive to your privacy concerns. We have a policy of protecting the confidentiality and security of information we collect about you. We are providing you this notice to help you better understand why and how we collect certain personal information, the care with which we treat that information, and how we use that information.

*Sources of Non-Public Information:* In connection with forming and operating our private investment funds, we collect and maintain non-public personal information from the following sources:

- Information we receive from you in conversations over the telephone, in voicemails, through written correspondence, via e-mail, or on subscription agreements, investor questionnaires, applications or other forms, and
- Information about your transactions with us or others.

*Disclosure of Information:* We do not disclose any non-public personal information about you to anyone, except as permitted by law or regulation and to service providers.

*Former Limited Partners and Clients:* We maintain non-public personal information of our former limited partners and clients and apply the same policies that apply to current limited partners and clients.

*Information Security:* We consider the protection of sensitive information to be a sound business practice, and to that end we employ physical, electronic and procedural safeguards to protect your non-public personal information in our possession or under our control.

*Further Information:* We reserve the right to change our privacy policies and this Privacy Notice at any time. The examples contained within this notice are illustrations only and are not intended to be exclusive. This notice complies with the privacy provisions of the Gramm-Leach-Bliley Act. You may have additional rights under other foreign or domestic laws that may apply to you.

For further information regarding PPMC’s privacy policies, please contact PPMC’s Chief Compliance Officer at 2 American Lane, Greenwich CT 06831 or by phone at (203) 861-8405.