

## ITEM 1 – COVER PAGE

Paloma Partners Management Company

Two American Lane

Greenwich, CT 06831

203.861.8405

[www.paloma.com](http://www.paloma.com)

March 28, 2013

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 PPMC’s Chief Compliance Officer at (203) 861-8405. Registration with the SEC does not imply a certain level of skill or training. The information in this Brochure has not been approved or verified by the SEC or by any state securities authority.

This Brochure is not: (i) an offer or agreement to provide advisory services to any person; (ii) an offer to sell interests (or a solicitation of an offer to purchase interests) in any Fund advised by PPMC; (iii) a complete discussion of the strategies, risks, or conflicts of interest associated with any Fund advised by PPMC; or (iv) to be relied on in determining whether to invest in a Fund or establish an advisory relationship with PPMC. The information provided in this Brochure about any Fund is qualified in its entirety by reference to the Fund Documentation.

Capitalized terms not otherwise defined herein are explained in **DEFINED TERMS**. Additional information about PPMC is also available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **ITEM 2 – MATERIAL CHANGES AND GENERAL INFORMATION**

PPMC no longer provides non-discretionary investment advisory services to the CPP Fund.

### ITEM 3 – TABLE OF CONTENTS

Item 1 – Cover Page .....	i
Item 2 – Material Changes and General Information .....	ii
Item 3 -Table of Contents .....	iii
Defined Terms.....	iv
Item 4 – Advisory Business .....	1
Item 5 – Fees and Compensation .....	4
Item 6 – Performance-Based Fees and Side-By-Side Management .....	9
Item 7 – Types of Clients.....	10
Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss.....	11
Item 9 – Disciplinary Information .....	21
Item 10 – Other Financial Industry Activities and Affiliations .....	22
Item 11 –Code of Ethics, Participation or Interest in Client Transactions and Personal Trading .....	25
Item 12 – Brokerage Practices .....	27
Item 13 – Review of Accounts.....	30
Item 14 – Client Referrals and Other Compensation.....	31
Item 15 – Custody .....	32
Item 16 – Investment Discretion .....	33
Item 17 – Voting Client Securities.....	34
Item 18 – Financial Information.....	34

## DEFINED TERMS

**CHINA MANAGERS:** New China Investment Management, Inc. (SEC File No. 802-73537), New China Capital Management, LP (SEC File No. 801-73538) and Cathay Master GP, Ltd. The China Managers provide investment advice to the China Funds.

**CHINA FUNDS:** Private equity funds that primarily invest in private companies operating in or affected by economic activity in China and securities reasonably related to such investments. The China Funds in which the Paloma Fund is currently invested include: the Cathay Investment Fund, Limited, Cathay Capital Holdings, L.P., Cathay Capital Holdings II, L.P. Additional information about the China Funds is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

**CPP FUND:** Fund-of-funds advised by TAM. The CPP Fund includes: Capital Preservation Partners L.L.C., Capital Preservation Partners Limited ("CPPL"), Capital Preservation Fund LLC ("CPF").

**DOMESTIC FEEDER FUND:** PPLLC is the Domestic Feeder Fund.

**FEEDER FUNDS:** PPLLC and PIL.

**FUND DOCUMENTATION:** Each Fund's confidential private offering memorandum (if applicable) and its governing documents.

**INVESTMENT PERSONS:** TAM, PPMC or the Portfolio Managers.

**JPMHFS:** JPMorgan Hedge Fund Services – the Paloma Fund's administrator.

**MASTER FUND:** PILP.

**OFFSHORE FEEDER FUND:** PIL.

**PALOMA FUND:** Paloma Partners, L.L.C. ("PPLLC"), Paloma International Limited ("PIL"), and Paloma International L.P. ("PILP").

**PALOMA MANAGEMENT:** Collective term for TAM and PPMC. Except with respect to the application of PPMC's policies and procedures, or as otherwise noted references to Paloma Management do not include PPMC Trading Teams (defined below).

**PORTFOLIO MANAGER:** Collective term for Trading Teams and Portfolio Funds.

**PORTFOLIO FUND:** External investment funds in which a Fund invests.

**PPMC:** Paloma Partners Management Company. Unless the context requires otherwise, references to the activities of PPMC do not include the activities of PPMC Trading Teams.

**PPMC TRADING TEAMS:** Trading Teams employed by PPMC on behalf of the Paloma Master Fund. The services provided by PPMC Trading Teams are governed by the terms of their employment agreements with PPMC.

SEC: U.S. Securities and Exchange Commission

TAM: Trust Asset Management, LLP (SEC File Number 801-74171). Additional information about TAM is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

TRADING TEAMS: Trading Teams that are generally engaged as independent contractors to the Paloma Master Fund (typically through its subsidiaries Sunrise Partners Limited Partnership and Sunrise Overseas Limited). However, PPMC may also employ Trading Teams on behalf of the Paloma Master Fund. Descriptions of Trading Teams and their activities in this Brochure also apply to PPMC Trading Teams unless otherwise noted.

#### ITEM 4 – ADVISORY BUSINESS

PPMC is a Delaware corporation and has its principal place of business in Greenwich, CT. PPMC was formed in 1989 by S. Donald Sussman to facilitate the operations of funds advised by him. PPMC is owned equally by Mr. Sussman, Douglas Ambrose, Michael Berner, Heather Garson, Gregory Hayt, Paul Kukuza, Gavin Morrocu and Randall Tam. Mr. Sussman is PPMC's Director. PPMC provides investment advisory services to the Fund separate and apart from TAM, but subject to TAM's ultimate authority. PPMC also facilitates the operations of, and implements certain controls for, the Fund. The Fund is PPMC's sole client.

TAM is a US Virgin Islands limited liability partnership established in 2001. Through TAM and other affiliated, and predecessor advisers owned and controlled by S. Donald Sussman, Mr. Sussman has been providing investment advice to private investment funds since 1981. Mr. Sussman provides investment advisory services to the Fund through TAM. Additional information about TAM is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

PPMC's investment advisory services are primarily related to the selection of Portfolio Managers and capital allocation among strategies. Investment advice is provided to the Fund pursuant to the terms of the Fund Documentation; investors in the Fund cannot obtain services tailored to their specific needs.

PPMC provides discretionary advisory services to the Fund in the following capacities:

- General Partner of PILP;
- Special Member of PPLLC; and
- Service provider to PIL.

PPMC also employs certain Trading Teams on behalf of the Fund. The services provided by PPMC Trading Teams are governed by the terms of their employment agreements with PPMC.

Additional information about PPMC's portfolio management activities and certain conflicts of interest related to such activities are provided in ITEMS 8 and 11 of this Brochure.

As of December 31, 2012, PPMC managed \$1.8 billion on a discretionary basis.

## THE PALOMA FUND

The Fund is a multi-manager, multi-strategy hedge fund which has no material limitations on the investment instruments, markets or countries in which the Fund may invest. Paloma Management seeks to balance the overall risk profile of the Fund to generate attractive long-term risk-adjusted returns with low correlation to major market indices. Paloma Management seeks to identify strategies with strong risk-reward opportunities given prevailing market conditions and find strong trading talent to execute those strategies. Paloma Management selects the strategies and Portfolio Managers, and makes the capital allocation and risk management decisions for the Fund. Paloma Management also trades for the Fund, primarily for hedging purposes.

Paloma Management is also responsible for the Fund's investments but has generally delegated responsibility for the execution of the Fund's strategies and day-to-day trading activities to Portfolio Managers. Capital is allocated directly and indirectly through the Master Fund among a diverse group of strategies executed by Portfolio Managers who are either Trading Teams or Portfolio Funds; the majority of the Fund's capital is managed by Trading Teams.

The Fund's model seeks to tie together the activities of the Portfolio Managers into an integrated hedge fund structure that allows for dynamic capital allocation, risk management and operational controls. Because Trading Teams trade on the Fund's balance sheet, and not through separate accounts, Paloma Management has daily (but not intra-day) transparency into the Fund's positions and transactions executed by Trading Teams (on a T+1 basis). This transparency, and the fact that Paloma Management has ultimate control over the Fund's capital, facilitates Paloma Management's ability to risk manage the Fund and dynamically allocate capital among strategies executed by Trading Teams. The Fund's operational controls are implemented by PPMC. These controls include:

- Portfolio risk management;
- Custody (Trading Teams are authorized to trade, but not exercise custody over the Fund's capital, e.g. move cash or securities);
- Reviewing and approving prime brokers and counterparties;
- Managing the Fund's exposure to prime brokers and counterparties;
- Controlling the Fund's leverage in consultation with TAM;
- Reviewing (in consultation with TAM) the valuations of the Fund's positions which are valued by JPMHFS pursuant to PPMC's pricing procedures;
- Managing the Fund's relationship with JPMHFS; and
- Providing tax, documentation, compliance and investor relations services to the Fund.

Trading Teams generally have discretion with respect to the execution of their investment mandate, which may be modified from time-to-time and is subject to Paloma Management's general direction concerning matters of risk and strategy. With the exception of PPMC Trading Teams, Portfolio Managers are responsible for their own operations and regulatory compliance obligations. 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.



## ITEM 5 – FEES AND COMPENSATION

### MANAGEMENT FEE

PPMC does not receive a fixed management fee or performance-based compensation from the Fund. The expenses of PPMC (such as salaries, bonuses and benefits paid to PPMC employees and all other overhead and operating expenses of PPMC) are passed-through to, and paid for by the Fund. The majority of PPMC's expenses are borne by the Fund although some of its expenses may be allocated to the CPP Fund.

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 ("TAM Management Fee"). TAM does not receive performance-based compensation from the Fund (Mr. Sussman receives performance-based compensation with respect to the Paloma Fund's investment in the China Funds – please see *COMPENSATION RECEIVED FROM OTHER FUNDS* below).

The TAM Management Fee may be subject to fee waivers with respect to particular investors (as described further below under "*FEE WAIVERS/REDUCTIONS*").

JPMHFS calculates the amount of the TAM Management Fee.

Additional information about the expenses passed-through to the Fund is provided below under "*EXPENSES*".

### *FEE WAIVERS/REDUCTIONS*

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

- (i) The TAM Management Fee with respect to certain investors, including, without limitation, investors that are partners, affiliates, or current and former 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.
- (ii) The Liquidity Capital Account Reduction (defined below) with respect to certain investors in the Fund, 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 Administrative and Operating Expenses (described below) cannot be waived, reduced, calculated differently or rebated (except in accordance with the Liquidity Capital Account Reduction) for any investor.

#### *COMPENSATION RECEIVED FROM OTHER FUNDS*

The Fund currently invests, and may in the future invest, in other vehicles from which TAM, Mr. Sussman, or an affiliate is entitled to receive compensation. In the event that the Fund invests, or commits capital to invest in a fund from which Mr. Sussman is entitled to Fees (an "Other Fund"), Mr. Sussman will waive, or cause to be waived, the portion of the TAM Management Fee that would have otherwise been charged to the Fund with respect to an amount of net asset value equal to the Paloma Fund's Investment Amount. For purposes of this provision, (i) "Fees" mean management fees, other asset-based fees, and performance based fees; and (ii) "Paloma Fund's Investment Amount" means the amount of capital invested or committed by the Fund in the Other Fund upon which the Other Fund calculates its management fees.

#### *MANAGEMENT FEE RESERVES*

If after giving effect to a withdrawal, an investor would be completely withdrawn from the 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 the TAM 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 EXPENSES**

*Portfolio Funds:* The Fund's investment in a Portfolio Fund is subject to that Portfolio Fund's asset-based and performance-based compensation as well as a share of that Portfolio Fund's expenses (which in certain cases may include some or all of the portfolio manager's out-of-pocket expenses).

*Trading Team Compensation:* The calculation methodology for management fees and performance-based compensation varies by Trading Team.

The management fee paid to a Trading Team is generally determined through negotiations with Paloma Management and may be based on: (i) committed capital, (ii) anticipated expenses, and/or (iii) any other basis deemed reasonable by Paloma Management. A Trading Team generally also receives a nonrefundable draw, which is generally treated as an advance against the performance-based compensation of that Trading Team (and may therefore be nonrefundable if the Trading Team does not generate sufficient performance-based compensation to repay the draw). The management fees are paid periodically in advance and performance-based compensation is accrued monthly and paid based on the calculation periods set forth in the investment management agreement.

Performance-based compensation is generally calculated based on a percentage of a Trading Team's net profits as of each calendar year-end and is generally subject to a hurdle rate and a high water mark. A high water mark may be waived or modified for a Trading Team if Paloma Management deems the waiver to be in the best interest of the Fund.

*Losses:* Performance-based compensation is payable to each Portfolio Manager based solely on its own performance. A Portfolio Manager with positive performance is entitled to receive performance-based compensation even if the overall performance of the Fund is negative.

If a Portfolio Manager suffers net losses during the year, the losses are generally carried forward and past losses must be made up before performance-based compensation becomes payable in subsequent years. There is no "carry back" or "claw back" of losses to permit recouping of profit interests from prior years.

### **LIQUIDITY CAPITAL ACCOUNT REDUCTION<sup>1</sup>**

Investors in the Fund electing a quarterly withdrawal cycle (instead of an annual withdrawal cycle) are subject to a Liquidity Capital Account Reduction at an annualized rate (depending on the value of the capital account balance) of either 0.25% or 0.50% of the relevant 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 administrative and operating expenses (including PPMC's 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.

The Liquidity Capital Account Reduction is deducted monthly in arrears.

### **ADMINISTRATIVE AND OPERATING EXPENSES**

Expenses allocated to the Fund are material, both on an absolute basis and as a percentage of the Fund's assets, and are generally borne pro rata by the Feeder Funds (and therefore by investors in the Feeder Funds). However, expenses may be allocated differently if Paloma Management determines that it would be fair and reasonable to do so, and TAM may bear the cost of certain expenses directly (e.g. placement agent expenses), rather than passing such expenses through to the Fund.

---

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

Each Feeder Fund will bear all of its direct and indirect expenses (as a pro rata share of all fees and expenses incurred in the Master Fund), including, without limitation the TAM Management Fee, expenses related to the investment activities of the Fund (including brokerage commissions, management fees and performance-based compensation paid to Portfolio Managers, and withholding taxes), organizational, offering, ongoing operating, administrative, offering, legal, audit, compliance, registrar and transfer agent fees and expenses, insurance and other expenses of any nature related to the business of the Fund. Expenses are deducted periodically in advance or arrears.

The Fund's ongoing operating expenses include PPMC's general administrative, overhead and other operating costs or expenses incurred in providing services to the Fund, and with respect to PIL, the cost of the offshore administrator and board of directors. The expenses for TAM's Chief Compliance Officer and other compliance related expenses (e.g. legal and consulting advice) related to TAM's, PPMC's, or the Fund's compliance requirements, including regulatory filings, are passed through to the Fund. A pro rata portion of these expenses is also allocated to the CPP Fund.

The types of expenses which may be passed through to the Fund by Paloma Management include, but are not limited to, the fees, costs or expenses related to:

- The salaries, bonuses, fringe benefits, continuing education, certifications, and professional licenses, of PPMC's employees;
- Consultants, subcontractors, agents, professional advisors, and recruiters;
- Computer hardware, software and other equipment including telephones and Blackberries;
- Reference materials, research services, data feeds, and industry publications;
- Leases for office space, expenses related to office fixtures, furniture, and maintenance;
- Travel, meal, lodging, and entertainment expenses related to investor relations, marketing, relationship development, due diligence, or respect to other permissible expenses (e.g. continuing education or recruiting);
- Maintenance, updates, and taxes related to any leases, services, contracts, hardware, or with respect to other permissible expenses described above;
- Other expenses related to PPMC's operations; and
- Any other fees and expenses incurred in connection with any transactions, engagement, or other agreements entered into by PPMC on behalf of the Fund including, among other things, the costs and expenses of JPMHFS and Trading Teams employed by PPMC on behalf of the Fund.

Please see ITEM 11 for information about the potential conflicts of interest with respect to the allocation of expenses to, and among the Feeder Funds.

**PIL- HEDGE CURRENCY SHARE CLASS**

Investors in PIL's non-US dollar share classes will bear the costs incurred by PIL in connection with hedging the currency risk exposure for any Euro Shares or Yen Shares, as applicable, including, without limitation, potential lost opportunity costs related to collateral or other requirements necessary to engage in the hedging activity (which may effectively reduce the amount of capital of hedge currency share class investors that is utilized by PIL for its investment program).

## **ITEM 6 – PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT**

Portfolio Managers are entitled to receive performance-based compensation which creates the following potential conflicts of interest:

- The receipt of performance-based compensation may incentivize a Portfolio Manager to make investments that are riskier or more speculative than it would make if it did not receive performance-based compensation. Furthermore, “net appreciation,” which is the basis for most performance-based compensation, includes unrealized appreciation, and may result in a Portfolio Manager receiving greater performance-based compensation than would be the case if net appreciation was based only on realized gains.
- A Portfolio Manager 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, a Portfolio Manager may be incentivized to allocate more profitable assets (or dedicate a great portion of its time) to clients that pay higher performance-based compensation than the Fund. Portfolio Managers maintain policies and procedures that seek fair allocation of time and investment opportunities among all clients.
- Performance-based compensation may encourage a Portfolio Manager to overvalue assets in order to increase the amount of its performance-based compensation.

## **ITEM 7 – TYPES OF CLIENTS**

PPMC provides discretionary portfolio management services to the Fund. In the future, PPMC may provide investment advice to other clients, including other private funds or separately managed accounts.

Interests in the Fund, and the Fund itself, are not registered under the U.S. Securities Act of 1933, as amended and are excepted from the definition of an “investment company” under Section 3(c)(7) of the Investment Company Act of 1940, as amended. Accordingly, interests in the Fund 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. Investors in the Funds are also Qualified Eligible Persons as defined in the Commodity Exchange Act.

The minimum investment is generally \$10 million for the Paloma Fund and may be waived in compliance with applicable law.

## ITEM 8 – METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS

### INVESTMENT AND TRADING RISKS- GENERALLY

*Market Risk:* Inherent in any investment in the Fund is the risk of a total loss of invested capital. Paloma Management seeks (but does not guarantee) to manage this risk through a careful selection of securities and investment opportunities, as well as through the application of an ongoing qualitative and quantitative risk assessment and management program. Neither Paloma Management, nor the Fund's Portfolio Managers can predict, measure, or hedge all market or other risks inherent in the Fund's investment strategies. Paloma Management or the Portfolio Managers may choose, or may determine that it is economically appropriate, to not hedge certain risks, instead relying on diversification in an attempt to mitigate the risks. However, the Fund is not limited by any specific policies or requirements for diversification or risk mitigation. The Fund will directly, and indirectly through an investment in a Portfolio Fund, be exposed to any or all of the following risks, any references to "the Fund" include Portfolio Funds unless otherwise specifically noted.

*Counterparty Risk:* The Fund may enter into transactions, including derivative and other over-the-counter transactions, with or through third parties in which the failure of the third party to perform its obligations could have a material adverse effect on the Fund. The counterparty risk is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where the Fund has concentrated its transactions with a single or small group of counterparties. The Fund's accounts generally are not segregated, bankruptcy-remote accounts titled in the owner's name and, therefore, a failure of any broker or market participant is likely to have a greater adverse impact than if the assets, or the accounts in which they are held, were registered in the name of the Fund. In addition, because the Fund's securities may be held in margin accounts, and the prime brokers have the ability to loan those securities to other persons, the Fund's ability to recover assets in the context of a bankruptcy or other failure of a prime broker may be further limited.

The Fund may transact with counterparties (including prime brokers) located in various jurisdictions outside the United States. The local counterparties are subject to various laws and regulations in various jurisdictions that are designed to protect their customers in the event of their insolvency. However, the practical effect of these laws and their application to the Fund's assets are subject to substantial limitations and uncertainties. Because of the large number of entities and jurisdictions involved and the range of possible scenarios involving the insolvency of a counterparty, it is impossible to generalize about the effect of their insolvency on the Fund's assets. Investors should assume that the insolvency of any significant counterparty would result in a loss to the Fund, which could be material.

*Limited Diversification:* Paloma Management generally seeks to diversify the Fund's investments. While Paloma Management monitors investment concentrations for risk management purposes, the Fund does not have fixed limits and guidelines regarding diversification of investments. As a result, the Fund may become concentrated in a single issuer, industry, market or sector. The concentration of risk may



increase losses suffered by the Fund. It is also possible that the Fund could become concentrated in any one strategy, and the investments of the strategy may be more illiquid than the investments in another strategy. It is possible that Paloma Management may select Portfolio Managers who make investments that are concentrated in a limited number of types of financial instruments. Limited diversification may cause greater volatility than would otherwise be the case, and could expose the Fund to losses disproportionate to market movements in general. Even if Paloma Management attempts to control risks and diversify the Fund, risks associated with different assets may become correlated in unexpected ways, with the result that the Fund becomes exposed to unforeseen risks. Although Paloma Management attempts to identify, monitor and manage significant risks, these efforts may not take all risks into account and there can be no assurance that these efforts will be effective.

*Market Restrictions:* Restrictions on investment size or investment activities imposed by various regulators or self-regulatory organizations and exchanges may limit the Fund's ability to effect transactions. Position limits, e.g. the maximum amounts of gross, net long or net short positions that any one person or entity may own or control in a particular financial instrument and other market restrictions, e.g. prohibitions on short sales, may require aggregation across the Fund (as opposed to by Portfolio Manager), for purposes of determining whether the applicable position limits have been exceeded, or short sales may be executed and may restrict the Fund's investment activities. As a result of these restrictions, the Fund (or Portfolio Fund) may be prevented from executing a desired transaction and may therefore incur losses which may be material.

*Valuation:* JPMHFS will value the Funds' assets in accordance with PPMC's securities pricing procedures. If Paloma Management determines that the valuation provided by JPMHFS does not fairly represent the value of an asset, then Paloma Management, in its discretion, will value such asset as it reasonably determines based on guidelines established by Paloma Management's policies. Net asset values will be calculated monthly as set forth in the Fund Documentation based upon unaudited information and may be adjusted retroactively following completion of a year-end audit or revised unaudited information from the issuers of portfolio investments.

In order to value the assets and liabilities of the Fund, Paloma Management may rely on information provided by Portfolio Managers or outside parties, and such information may be inaccurate, incomplete, out of date or otherwise unreliable. Paloma Management may be unable to detect every error contained in the valuation information. To the extent the information received by Paloma Management is inaccurate or unreliable, the valuation of the Fund's assets and liabilities may be inaccurate.

*In-Kind Distributions:* Securities distributed in-kind will be valued as of the relevant redemption date in accordance with the Fund's valuation policies. The assets from distributions in-kind may not be readily marketable, and withdrawing investors will bear the investment-related, transactional, operating and overhead expenses related to the management and disposition of assets whether distributed directly or through the use of a liquidating trust. Moreover, the realized values of the assets will likely differ, in some cases materially, from the fair market value on the redemption date.

*Trade Error Risk:* Many of the investment techniques used by the Fund's Portfolio Managers require the rapid and efficient execution of transactions, or the ability of the Portfolio Managers to accumulate or liquidate large positions. Inefficient execution can impair realization of the market opportunities sought with the techniques. Occasionally, transactions may be executed erroneously on terms other than those intended by Portfolio Manager. For example, a transaction may be executed in the wrong asset, for the wrong quantity or price, to buy when the Portfolio Manager meant to sell, to sell when the Portfolio Manager meant to buy or by reason of a programming error in a trading program. Except to the extent otherwise required by law, the Fund will generally bear the losses or costs of any such errors, unless it is determined that the error was caused by gross negligence.

## **INVESTMENT STRATEGIES, INSTRUMENTS AND RELATED RISKS**

The following is a summary of (i) the strategies and methods Paloma Management and/or Portfolio Managers use in formulating advice or managing assets (and their material risks) for the Fund, and (ii) certain material risks associated with the types of securities that Paloma Management and/or Portfolio Managers primarily recommend to the Fund (or the Portfolio Funds in which the Fund invests). Any or all of the strategies described below may be undertaken in developing or emerging markets, or in the securities of companies based in developing or emerging markets.

In the execution of these strategies, Portfolio Managers may trade or invest, directly or indirectly, on margin or otherwise, in all forms of securities and other financial instruments, where "securities" and "financial instrument" are given their broadest possible meanings and include any interest of any kind commonly referred to as securities.

The Fund may employ additional strategies, or variations of these strategies without advance notice to investors. Additional strategies and variations of strategies may involve higher levels of risk.

*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 or 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. Investments 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. Investments may also include 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. Strategies 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:* Positions in short securities are speculative and may be riskier than “long” positions because the cost to buy back the security is unknown. The potential loss on an uncovered short sale is unlimited.

*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 with the expectation of profiting from the impact of the event on the price of such securities at the inception of the investment and the price of such securities. For example, 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.

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 litigation, 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. 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 or below investment grade rated companies. Positions 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 risk 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 by 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 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.

*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. Expected inefficiencies may fail to materialize. 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. The Fund may also leverage its investment return with options, short sales, swaps, forwards and other derivative instruments.

*Risks:* While leverage presents opportunities for increasing total return, it has the effect of potentially increasing losses as well. Accordingly, any event which adversely affects the value of the 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.

*Risks:* There can be no assurance that 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 provide 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 typically through a "going public" transaction or in a private sale of the Funds' interest.

*Risks:* Exit transactions may not occur. Investments may subject the Fund to additional risks of litigation, 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.

*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, futures, options, or derivatives related to commodities, including agricultural products, energy products, metals and minerals, among others, utilizing both technical and fundamental

analysis of relevant markets. The Fund may also 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, options, and other negotiated instruments are subject to the risk of non-performance by a counterparty, market risk and 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.

*Debt Securities:* Debt securities, including convertible debt securities, may be subject to price volatility due to various factors including changes in interest rates, creditworthiness of the issuer, and liquidity. In addition to the sensitivity of debt securities to overall interest rate movements, debt securities are exposed to the issuer's credit risk.

*Government Securities:* Government securities may fluctuate significantly in response to factors including but not limited to: interest rates, political or social instability, fiscal policy, and credit ratings.

*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: (i) 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 (ii) 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:* Trading in options can result in large amounts of leverage which 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 purchased call, or an increase (or inadequate decrease) in the price of the underlying security in the case of a purchased 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 negotiated instruments are subject to the risk of non-performance by the swap counterparty.

*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.

*Repurchase Agreements:* Repurchase agreements involve credit risk to the extent that the 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, rule changes and restrictions on capital movement.

## **RISKS RELATED TO PORTFOLIO FUND INVESTMENTS**

The Fund's investments in Portfolio Funds present additional risks to investors. These additional risks include, without limitation:

*Liquidity Risk:* Investments in a Portfolio Fund is subject to liquidity constraints, e.g. lock-ups, notice requirements or gates which can prevent, or limit the Fund's ability to redeem from a Portfolio Fund.

*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 a Portfolio Fund (or any other person with access to a Portfolio Fund's assets) could divert or abscond with Portfolio Fund's 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 a Portfolio Fund.

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

## **DISCLAIMER**

The information included in this ITEM 8 does not include every potential risk associated with each investment strategy or security. Investors and prospective investors in the Fund are urged to ask questions regarding risk factors applicable to a particular investment strategy or security, read all product-specific risk disclosures (for example, the Fund Documentation) and determine whether a particular strategy or type of security is suitable for his/her/its own account in light of his/her/its circumstances, investment objectives and financial situation. Investing in securities involves risk of loss, possibly a total loss of invested capital that investors should be prepared to bear.

There is no guarantee that the Fund's investment program, including, without limitation, its investment objectives, strategies, or risk monitoring goals will be successful. Investment results may vary substantially over time. Investments in the Fund are speculative and involve a high degree of risk. There may be risks which cannot be monitored or controlled, and risks that may be greater than forecasted, especially in unusual market conditions. Paloma Management cannot guarantee that any assumptions relied on herein will be true for all future events or that all assumptions have been considered or stated.

## **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

### *PPMC*

PPMC is a member of the NFA (“National Futures Association”), a registered commodity pool operator and swap firm. The owners of PPMC are registered with the NFA as principal and PPMC employees involved in investor relations are registered with the NFA as associated persons.

### *TAM*

TAM is a member of the NFA, a registered commodity pool operator and swap firm. The Funds are registered commodity pools. Mr. Sussman is also registered with the NFA as a principal, an associated member, associated person, and a swap associated person of both TAM and PPMC.

### *China Managers*

Mr. Sussman directly and indirectly owns (including through TAM), a controlling interest in the China Managers.

Because of the affiliation between Paloma Management and the China Managers, there may appear to be a conflict between Paloma Management’s fiduciary duties toward their clients and the benefits accruing to Mr. Sussman (for example, increasing the assets under management of a China Fund). However, as described above, TAM waives the TAM Management Fee in respect of the Fund’s investments in the China Funds.

### *Pacific Alternative Asset Management Co LLC*

Mr. Sussman has a passive indirect ownership interest<sup>2</sup> in Pacific Alternative Asset Management Co LLC (SEC File No. 801-57416) (“PAAMCO”). Mr. Sussman is registered with the NFA as a principal of PAAMCO.

Mr. Sussman does not currently participate in the management of Pacific Alternative Asset Management Co LLC.

## OTHER INVESTMENT ACTIVITIES

Investment Persons may engage directly or indirectly in any business or other activities, including 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 other clients. These activities may conflict with Investment Persons’ activities on behalf of their clients. For example, 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 the Fund.

---

<sup>2</sup> Mr. Sussman owns Franklin Realty Company, which owns Franklin Realty Holdings LLC, which has a substantial ownership interest in PAAMCO Founders Co., LLC, which owns the majority of PAAMCO.

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

Investment Persons do not have any obligation to purchase or sell, for the Fund, 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.

In certain circumstances, the Funds may invest in securities or other instruments of the same issuer (or affiliated group of issuers) having a different seniority in the issuer's capital structure. If the issuer becomes insolvent, restructures or suffers financial distress, there may be a conflict among the interests of the Funds, insofar as the issuer may be unable (or in the case of a restructuring prior to bankruptcy may be expected to be unable) to satisfy the claims of all classes of its creditors and security holders. Under these circumstances it may not be feasible to reconcile the conflicting interests with the Fund in a way that protects the Fund's interests.

#### *Board Memberships*

Investment Persons may serve as directors of companies in which the Fund invest. In addition to any fiduciary duties owed to the Fund, as a director of a company, an Investment Person also owes a fiduciary duty to the company. Board memberships may place an Investment Person in a position where they must make a decision that is not in the best interests of the Fund.

#### *Personal Interests in Other Funds*

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

- Certain Investment Persons do own and may in the future acquire additional interests in certain of their clients (including the Fund).
- 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)).

Paloma Management has in place various policies and procedures to ensure that the Fund is treated fairly and that Investment Persons act in the best interests of the Fund (see, for example, Paloma Management's allocation procedures, as described below).

#### *Master-Feeder Structure*

The Feeder Funds invest through a master-feeder structure which may create a conflict of interest in that different tax considerations 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 a Feeder Fund. 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 the other Feeder Fund. Paloma Management or its affiliates, including Mr. Sussman, may, and typically do, have a disproportionate investment in one of the Feeder Funds and may, therefore, receive any benefit derived disproportionately by that Feeder Fund.

#### *Allocation Policy*

PPMC's sole client is the Paloma Fund.

The Paloma, CPP and China Funds have relatively distinguishable mandates: the Paloma Fund typically invests through managed accounts and makes other opportunistic investments; the CPP Fund typically invests in other hedge funds, and; the China Funds invest primarily in private companies operating in China. To the extent that any of these funds make investments which may appear to be more suitable for another fund (e.g. if the Paloma Fund invests in another hedge fund) the rationale for the allocation decision will be documented.

#### *Letters of Understanding a/k/a "Side Letters"*

By entering into side letters, certain investors in the Fund may receive information that is not generally requested or utilized by other investors in the Fund and as a result, may be able to act on such information (i.e., request redemptions).

Any rights related to access to information that are given to any investor in the Fund are made available to all investors.

## **ITEM 11 – CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING**

PPMC's Code of Ethics requires Access Persons to provide PPMC's Chief Compliance Officer with initial and annual holdings reports (excluding accounts holding certain securities or discretionary accounts) and quarterly transactions reports. Access Persons are also generally prohibited from participating in initial public offerings and executing transactions in issuers included on PPMC's Restricted List, certain employees of PPMC and members of the Fund's Investment Committee must also obtain preapproval from PPMC's Chief Compliance Officer prior to investing in any private placement. The Chief Compliance Officer reviews violations of the Code of Ethics to determine appropriate internal sanctions.

If there is adequate capacity, TAM, and/or its affiliates may invest, or co-invest directly, side-by-side or otherwise (through special purpose vehicles created by those parties, in conjunction with third parties or otherwise) in a Portfolio Fund or any other investments of the Fund. In the event that a conflict of interest arises, TAM will seek to resolve such conflicts in a fair and equitable manner.

Investors and prospective investors in the Fund may obtain a complete copy of PPMC's Code of Ethics free of charge by submitting a written request to PPMC's Chief Compliance Office, Heather Garson, at Two American Lane, Greenwich, CT 0681 or by phone at (203) 861-8405.

### *Expenses*

Investors and prospective investors should note that PPMC may have a conflict with respect to controlling its expenses, as the Fund Documentation does not limit the amount of PPMC's expenses that the Fund may pay, advance or reimburse.

PPMC has established policies and procedures to review its expenses for compliance with expense disclosures in the Fund Documentation. The expense allocation policies and procedures seek to allocate costs and expenses equitably. While PPMC believes its methodologies are reasonable, reasonable alternative methodologies may exist which could yield different results.

PPMC believes its expense allocation procedures provide an objective methodology for allocating expenses, and serve to mitigate any potential conflict arising from their employees' investments in certain of those funds.

### *Affiliated Investments, Cross Trades and Principal Trades*

Investment Persons may act in multiple capacities, and may effect transactions with, or for an account in instances in which Investment Persons may have multiple interests. Paloma Management has, and may in the future invest assets of the Fund in funds managed by its affiliates.

Investment Persons 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 other funds managed by Investment Persons. The determination by Paloma Management to effect any such

investment will be based on such criteria as Paloma Management may determine to be appropriate at the time.

It is possible that other funds 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 Fund to lower fees and expenses.

Trading Teams have established, and may in the future establish, one or more Portfolio Funds. In such instances, the Fund typically receives a share of the management fees and performance-based compensation generated from those Portfolio Funds. Such interests may be in the form of a special class of shares or limited partnership interest in the Portfolio Fund (or an affiliated fund), or a contractual agreement with the Portfolio Fund (or an affiliated fund) or its portfolio manager.

The Fund does not, but may in the future, engage in principal or cross trades. This Brochure will be modified and investors will be informed of any future changes with regard to these types of transactions.

## ITEM 12 – BROKERAGE PRACTICES

### *Selection of Broker-Dealers*

Paloma Management has the authority to determine without client consultation or consent the broker-dealer or other counterparty through which securities or other instruments are bought and sold, and the commission rate (or other cost) at which transactions are effected.

Because most of the Fund's assets are currently managed by Trading Teams or through Portfolio Funds most trading decisions are made at the Portfolio Manager level. However, Paloma Management may transact on behalf of the Fund. For the purpose of this ITEM 12, the term "Portfolio Managers" also includes Paloma Management.

PPMC reviews, approves and monitors the prime brokers, executing brokers-dealers and counterparties used by Trading Teams. Executing broker-dealers and counterparties are chosen by each Trading Team from those that have been reviewed and approved by PPMC.

With respect to soft dollar arrangements, the conflicts that typically give rise to concerns underlying the use of soft dollars do not generally exist for Paloma Management, because the Fund (and not Paloma Management) bears all of the expenses related to its operations. Therefore, the use of soft dollars does not result in any expense shifting between Paloma Management and the Fund.

In selecting brokers and dealers to effect portfolio transactions Portfolio Managers may consider factors as they deem appropriate (and consistent with their obligation to seek best execution) to consider under the circumstances, which may include one or more of the following:

- 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 (defined below);
- idea generation;
- competitive rates; 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.

Portfolio Managers do not have an obligation to obtain the lowest available commission cost. Accordingly, if a Portfolio Manager determines in good faith that the commissions charged by a broker or the transaction costs charged by a dealer are consistent with their obligation to seek best execution and are reasonable in relation to the value of the Products or Services provided by the broker or dealer, the Fund may pay commissions to the broker or transaction costs to the dealer in an amount greater than another might charge to execute the same transaction.

From time to time, the Fund may be introduced to potential investors interested in investing through “capital introduction” events sponsored by the Fund’s prime brokers. Neither Paloma Management nor the Fund compensates any prime broker for organizing the events or for investments in the Fund ultimately made by prospective investors attending the events. However, the events and other services (including, without limitation, capital introduction services) provided by a prime broker may influence Paloma Management to some extent in selecting prime brokers and determining the extent to which a prime broker will be used.

Soft dollar arrangements provide an incentive to select or recommend a broker-dealer based on an interest in receiving Products or Services, rather than on receiving most favorable execution. Soft dollar arrangements may cause the Fund to pay commissions (or markups or markdowns) higher than those charged by other broker-dealers in return for soft dollar benefits (known as paying-up). Portfolio Managers with clients in addition to the Fund (or a Portfolio Fund in which the Fund is invested) may also benefit from the use of soft dollars. Therefore, it is theoretically possible that another fund will benefit (which benefit may be disproportionate relative to its contribution to the expenditure that generated them) from soft dollar services paid for by the Fund.

To the extent that the Fund's commissions are used to acquire 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).

A consequence of the use of soft dollar arrangements is that, under GAAP, items that would otherwise have been characterized as expense in the consolidated financial statements of the Paloma Fund will instead be included within commissions. As a result, line-item expenses will appear smaller than they would have had soft dollars not been utilized. It is possible that some expenses paid through the utilization of soft dollar arrangements might be greater than if the Products and Services had been purchased directly.

Investors cannot direct brokerage.

*Trade Errors:* The Fund (and not Paloma Management or Trading Teams) 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 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 Fund, investors should assume that trading errors (and similar errors) will occur and that the Fund will be responsible for any resulting losses, even if such losses result from negligence.

## ITEM 13 – REVIEW OF ACCOUNTS

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

PPMC has developed a proprietary Risk Management System that has functioned for many years as a key component of the Fund's operations. Paloma Management monitors and analyzes the portfolio using PPMC's Risk Management System, other tools, research, expertise and knowledge, and adjusts risk when appropriate.

The Risk Management System captures positions, terms and conditions of securities, pricing and market data, as well as other position level details about the Fund's holdings and transactions. The Fund is then analyzed using proprietary and commercially available pricing models, standard and proprietary risk measures resulting in quantitative data and summary statistics which may be further analyzed as necessary. The Risk Management Group also has ongoing discussions with Trading Teams about their strategies in order to gain insight into the risks that may not be reflected in the quantitative data and summary statistics.

### *Reports to Clients*

Every investor in the Fund at any time during the fiscal year receives annual financial statements audited by an independent public accounting firm. Investors also receive monthly statements, periodic investor letters, and monthly portfolio reports.

#### **ITEM 14 – CLIENT REFERRALS AND OTHER COMPENSATION**

PPMC, TAM or the Paloma Fund may enter into arrangements with third parties whereby such third parties receive fees (from TAM – not the Fund) for introducing investors to the Paloma Fund pursuant to a written agreement and in compliance with applicable rules and regulations.

## **ITEM 15 – CUSTODY**

To the extent required by applicable law, the Fund's securities and funds are held by qualified custodians. Investors in the Fund receive annual financial statements audited by an independent public accounting firm, within 120 days of the fiscal year end, for the Fund in which they have invested.

## **ITEM 16 – INVESTMENT DISCRETION**

PPMC exercises discretion in managing the Fund based on the Fund’s investment objectives, policies and strategies disclosed in the applicable Fund Documentation. PPMC typically assumes this authority through its agreements with the Fund. PPMC’s investment discretion is subject to TAM’s ultimate authority.

## **ITEM 17 – VOTING CLIENT SECURITIES**

### *Summary of Proxy Voting Policies and Procedures*

As a general matter, Paloma Management does not vote proxies and investors may not direct Paloma Management'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's assets managed by that Trading Team. Trading Teams are expected to vote proxies only if proxy voting is relevant to their investment strategy, and if proxies are voted, in the best interest of the Fund

Portfolio Funds vote proxies in accordance with their own proxy voting policies.

Investors in the Fund may obtain a complete copy of PPMC's Proxy Voting Policy and Procedures or information on how Paloma Management voted proxies for the 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.