

## 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 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**

None.

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## 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. and Cathay Capital Holdings III, 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").

**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 Fund's administrator.

**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.

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

**Other Investments:** External investment funds in which the 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.

**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, Heather Garson, Gregory Hayt, Paul Kukuruza, Gavin Morrocu and Randall Tam. Mr. Sussman and Mr. Hayt are PPMC's Directors. PPMC provides investment advisory services to the Fund separate and apart from TAM, but subject to TAM's ultimate authority. The Fund is PPMC's only client.

PPMC also facilitates the operations of, and implements certain controls for, the Fund. The Fund's operational controls include: ongoing due diligence reviews of portfolio managers; approving, monitoring, managing and negotiating the Fund's counterparty, prime brokerage, custodial and financing arrangements; monitoring the Fund's credit and counterparty risk exposure; accounting and administration (including managing the Fund's relationship with its third-party administrator); compliance; legal documentation; tax advice; and information technology (including managing the Fund's relationship with its third-party technology service provider).

In addition to the foregoing services, PPMC 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. Except with respect to the application of PPMC's policies and procedures, or as otherwise noted references to Paloma Management do not include PPMC's Trading Teams.

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).

Paloma Management has ultimate discretion and control over the Fund and its investments. Its responsibilities to the Fund include but are not limited to: strategy and portfolio manager selection; allocation of capital or risk capital (as applicable); risk management; and hedging the Fund's exposures as it deems appropriate. Investment advice is provided to the Fund pursuant to the terms of the Fund's Documentation; investors in the Fund cannot obtain services tailored to their specific needs.

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, 2013, PPMC managed \$2.2 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 Fund's strategies and Portfolio Managers, and makes the capital allocation and risk management decisions for the Fund.

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 Other Investments; the majority of the Fund's capital is managed by Trading Teams. However, Paloma Management also trades for the Fund, primarily for hedging purposes.

The Fund's model seeks to tie together the activities of the Portfolio Managers into an integrated hedge fund structure that allows for centralized 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, ongoing liquidity, 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 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 Other Investments 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.

No guarantee or representation is made that the Fund's investment program, including, without limitation, its investment objectives, diversification, strategies or risk monitoring processes will be successful. The risk management process includes an effort to monitor and manage risk, but does not imply low risk. There may be risks which are not monitored or controlled by Paloma Management, and risks that may be greater than forecasted, especially in unusual market conditions. Nothing herein is intended to imply that the Fund's investment strategy is "conservative", "safe", "risk free", or "risk averse". There can be no assurance that the Fund's investment objective will be achieved or that its portfolio design and risk monitoring strategies will be successful. Investors may lose all or substantially all of their capital.

## 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 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.

Class A and B Interests/Shares: TAM is generally entitled to receive 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").

Class C and D Interests/Shares: TAM is generally entitled to receive an incentive fee at the end of each calendar year (or as of any redemption date in the case of redemptions occurring at times other than year-end) in an amount equal to 20% of the net realized and unrealized capital appreciation attributable to an investor's capital account balance or net asset value, as applicable ("TAM Incentive Fee").

Mr. Sussman also receives compensation with respect to the Fund's investment in the China Funds – (please see *COMPENSATION RECEIVED FROM OTHER FUNDS* below).

The TAM Management or Incentive 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 and Incentive 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 or Incentive 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 or TAM Incentive Fee, as applicable, that would have otherwise been charged to the Fund with respect to an amount of net asset value equal to the 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.

#### *FEE AND EXPENSE 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, Paloma Management 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 fees and expenses 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*

*Other Investments:* The Fund's investment in Other Investments is subject to that Other Investment's asset-based and performance-based compensation as well as a share of that Other Investment'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 may also receive 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 or Incentive 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

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<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.

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.

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 or Incentive Fee, as applicable, 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, 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 Paloma Management'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 portion of certain compliance 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;
- Facilities and overhead expenses including expenses related to office improvements, fixtures, furniture, and maintenance;
- Travel, meal, lodging, and entertainment expenses related to investor relations, marketing, relationship development, due diligence, or for purposes related 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;

- Directors' and officers' insurance and errors and omissions insurance, if any; and
- 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 the Fund.

*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 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**

TAM and 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 TAM or 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 TAM or a Portfolio Manager receiving greater performance-based compensation than would be the case if net appreciation was based only on realized gains.
- TAM or 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, TAM or 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. TAM and Portfolio Managers maintain policies and procedures that seek fair allocation of time and investment opportunities among all clients.
- Performance-based compensation may encourage TAM or 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 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*

The Fund's investment program is speculative and involves a high degree of risk, including, without limitation, risks associated with limited diversification, leverage, interest rates, currencies, volatility, tracking risks in hedged positions, security borrowing risks in short sales, credit deterioration or default risks, operational risks, counterparty risk and other risks inherent in the Fund's activities and financial instruments traded. Certain investment techniques (*e.g.*, the use of leverage), can, in certain circumstances, magnify the impact of adverse market moves to which the Fund may be subject. In addition, the Fund's investments may be materially affected by conditions in the financial markets and overall economic conditions occurring globally or in particular countries or markets where the Fund may invest its assets. There may be risks which are not monitored or controlled by Paloma Management and risks that may be greater than forecasted, especially in unusual market conditions. Also, information used to manage risks may not be accurate, complete or current, and such information may be misinterpreted.

*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.

*No Fixed Strategy, Instruments, Markets, Sectors or Issuer Weightings:* The Fund will opportunistically implement whatever strategies or discretionary approaches Paloma Management believes from time to time may be suited to prevailing market conditions. The risks associated with such strategies may be different from those described herein. There can be no assurance that Paloma Management will be successful in selecting any such strategy or discretionary approach and that losses will be avoided.



*Discretion of Paloma Management; New Strategies and Techniques:* Paloma Management has considerable discretion in the types of financial instruments that the Fund may trade and has the right to modify, and will modify, the trading strategies or hedging techniques of the Fund without notifying investors or seeking their consent. Any of these new trading techniques may not be thoroughly tested in the market before being employed and may have operational or theoretical shortcomings that could result in unsuccessful trades and, ultimately, losses to the Fund. In addition, any new investment strategy or hedging technique developed by the Fund may be more speculative than earlier techniques and may increase the risk of an investment in the Fund.

*Competition:* There is currently, and will likely be, competition for investment opportunities with others having investment objectives and strategies like those of the Fund. The Fund also competes for investment professionals having expertise in those investment opportunities. If competition prevents or hinders the Fund's ability to participate in certain investment opportunities or obtain the best investment professionals, the Fund's performance may suffer.

*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*

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, Paloma Management and/or 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.

Depending upon the investment strategies employed and market conditions, the Fund may be adversely affected by unforeseen events involving such matters as changes in interest rates, the credit status of an issuer, forced withdrawals of securities, break-up of planned mergers, unexpected changes in relative value, short squeezes, an inability to short stock or changes in tax treatment, among others.

All strategies carry a risk of loss. Certain risks are inherent, or more likely to impact a particular strategy or transaction, while other risks are related to the markets in which the Fund may trade or the instruments are traded. Market risk is inherent in all securities investments to varying degrees, and there can be no assurance that the investment objective of the Fund will be achieved. Certain investment practices may increase the risk profile of the Fund. The Fund’s activities could result in substantial losses (including the complete loss of capital) under certain circumstances.

The following is a description of certain investment strategies employed by the Fund. While Paloma Management currently expects that Other Investments, as well as the Fund, will primarily engage in these types of strategies, the Fund and Other Investments may engage in investment strategies and trade in financial instruments that are not described in this Memorandum. These descriptions do not in any way limit the Fund’s or Other Investments’ investment activities. The Fund may combine these strategies into more general categories for purposes of portfolio and risk reporting.

*Statistical Arbitrage and Systematic Futures Strategies (Algorithmic Strategies)* use quantitative methods and statistical models which seek to identify mispricings among securities and futures based on various

metrics such as deviations from equilibria, momentum, pattern recognition, volume, or flow-driven momentum and factors underlying security price variations. The frequency of trading varies by model, but may be high. These portfolios may have directional exposure but generally seek to generate returns with minimal correlation to directional moves of the major markets.

*Fundamental and Directional Strategies* measure the intrinsic value of a security by looking at economic and financial factors (including the overall economy, industry conditions, and the financial condition, prospects and management of a company itself) to determine if a company is underpriced (indicating it may be a good time to buy) or overpriced (indicating it may be time to sell).

*Commodities Strategies* trade commodities, futures, options, or derivatives on agricultural and energy products, metals and minerals, among others, based on technical and fundamental analysis of relevant markets. Investments can also include the equity of companies that produce, process, convert, transport and service commodities.

*Volatility and Correlation Strategies* trade derivatives (typically derivatives in which optionality plays a role) that are linked to the realized or implied volatility of an asset or basket of assets, or to the correlation of one or more assets.

*Fixed Income Strategies* typically include long and short credit positions based on quantitative or qualitative analysis of various fixed income securities to capture inefficiencies in the relative pricing of similar instruments. Instruments traded typically include bonds (including fixed, floating rate and zero coupon bonds), sovereign debt, interest rate swaps, futures contracts, forward contracts, government sponsored agency debt, mortgage backed securities, asset backed securities or related derivatives. These strategies may have significant directional exposure to take advantage of market dislocations.

*High Yield Strategies* trade and invest in credit derivatives, bank debt, senior and subordinated bonds, equity or other securities of unrated or below investment grade issuers based on an assessment of fundamental values.

*Capital Structure Strategies* seek to exploit pricing inefficiencies and informational asymmetries through a diversified portfolio of offsetting long and short positions within companies' capital structures. Investments can include bank debt, convertible and non-convertible senior and subordinated debt, and preferred and common stock of one or more companies.

*Convertible Securities Strategies* seek to exploit price differentials (spreads) between convertible securities and the underlying security. Instruments traded typically include bonds, preferred and common stock, and derivatives.

*Long/Short Strategies* seek to generate alpha and mitigate correlation to major market directional movements by establishing long and short positions in securities, indices, ETFs or baskets of securities. These strategies can either be market neutral or have some directional exposure.

*Distressed Strategies* generally invest in the securities and other assets of issuers in weak financial condition (perhaps having a negative net worth), experiencing poor operating results, needing substantial capital investment, facing special competitive or product obsolescence problems, or involved in various stages of bankruptcy or reorganization proceedings.

*Event Driven, Special Situation and Merger Arbitrage Strategies* involve investments in opportunities created by certain current or expected events or special situations and may involve a long or a short view with respect to an issuer depending on the anticipated outcome of particular events or transactions. The strategies trade in the securities of publicly-traded companies in announced or prospective mergers, acquisitions, cash tender-offers, exchange offers, corporate recapitalizations or other corporate actions, including the anticipation of such events occurring in the future.

*Activist Strategies* seek to make investments for the purpose of influencing the management of a company (which may take a cooperative or hostile approach) to realize value through, for example, going private transactions, management changes, divestitures or acquisitions. These strategies typically involve acquiring a substantial ownership stake in an issuer either alone, or in conjunction with others.

*Investments in Private Equity/Private Placements* are medium to long-term investments in private companies that are not publicly traded securities. In addition to purchasing a company's equity, investments may be in mezzanine debt or other types of financing. Exit transactions from these investment typically involve, but are not limited to, initial public offerings (after which time, the Fund's interests may be subject to transfer restrictions for periods of time) or private sales of the Fund's investment.

*Investments in Real Assets* are typically opportunistic investments in physical, tangible assets which may include: commodities, equipment, natural resources or property. These investments may be longer-term investments.

*Macro Economic Strategies* seek to profit by capturing market movements across a global universe of investment opportunities, such as equity, currency, commodity and fixed-income markets, based on a broader economic analysis than would be used for the purchase or sale of specific securities. These strategies may be directional and seek to exploit mispricings across markets and geographies.

*Fund-Level Hedging Strategies* seek to limit the exposure of the Fund to rapid, adverse changes in the market environment and to "tail risks." However, Paloma Management is not obligated to hedge any specific risk and may elect not to hedge against certain risks or to alter the extent to which the Fund is hedged from time to time.

*Investments in Developing or Emerging Markets* may utilize any or all of the strategies described herein.

#### **INVESTMENT STRATEGIES - RISKS**

*Statistical Arbitrage and Systematic Futures (Algorithmic Strategies):* It is difficult to predict market movements. These strategies may not be successful if the securities are ultimately unrelated, unexpectedly become correlated or otherwise do not move as anticipated. Perceived mispricings may fail to materialize as expected. Markets for certain securities traded in these strategies may be inefficient or illiquid and calculations of discounts may involve significant uncertainties. Predicted volatilities underlying an issuer's securities may fail to materialize. There may be significant directional exposure to the volatility of one or more assets or the correlation of two or more assets.

*Model-Based Trading:* The Fund may use an investment strategy that is determined principally by the concepts included in a model and the recommendations generated by the model. The Fund is unlikely to be successful unless both the underlying assumptions of the model and the concepts utilized by the model are reliable. If such assumptions and concepts are unreliable, it is likely that the reports generated by the model will not generate profitable investment recommendations. The model may be more effective with certain securities than with others, and not all factors driving securities prices can be identified, much less quantified by the Portfolio Managers. Quantitative models may be ineffective or may contain human or electronic errors (in coding, inputs or otherwise) that are either not discovered, or if discovered not disclosed to Paloma Management.

*Fundamental or Directional Investments:* The identification of investment opportunities in undervalued or overvalued securities is a difficult task, and there are no assurances that such opportunities will be successfully recognized. While these investments offer the opportunity for above-average capital appreciation, they also involve a high degree of financial risk and can result in substantial losses. There is a risk that the price of a security can move up or down along with the overall market regardless of the company's economic and financial condition.

*Macro-Economic:* Macro-economic based strategies depend on the ability to successfully exploit 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 the Fund 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. Futures markets are also subject to regulations and limited trading which may prevent a position from being closed out when desired.

*Short Selling:* A short sale creates the risk of a theoretically unlimited loss, in that the price of the underlying security could theoretically increase without limit, thus increasing the cost to the Fund of buying those securities to cover the short position. Furthermore, there is no assurance that the

securities necessary to cover a short position will be available for purchase, and purchasing securities to close out the short position can itself cause the price of the securities to rise further, thereby exacerbating the loss. The securities borrowed by the Fund to effect the short sale may be recalled by the lender of those securities at any time, thus forcing the Fund to purchase the securities to close out the short position at a loss.

*Event Driven, Special Situations and Merger Arbitrage:* These strategies rely on a Portfolio Manager's ability to make 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. For example, the adoption of new business strategies or completion of asset dispositions or debt reduction programs by a company may not be valued as highly by the market as anticipated, resulting in losses. In addition, a company may announce a plan of restructuring which promises to enhance value and fail to implement it, resulting in losses to the Fund. In liquidations and other forms of corporate reorganization, the reorganization may be unsuccessful, may be delayed or may result in a distribution of cash or a new security, the value of which may be less than the purchase price to the Fund of the security in respect of which such distribution was made. The consummation of mergers and tender and exchange offers can be prevented or delayed by a variety of factors, including, but not limited to: (i) opposition of the management or stockholders of the target company, which will often result in litigation to enjoin the proposed transaction; (ii) intervention of a federal or state regulatory agency; (iii) efforts by the target company to pursue a "defensive" strategy, including a merger with, or a friendly tender offer by, a company other than the offeror; (iv) in the case of a merger, failure to obtain the necessary stockholder approvals; (v) market conditions resulting in material changes in securities prices; (vi) compliance with any applicable federal or state securities laws; and (vii) inability to obtain adequate financing. Because of the inherently speculative nature of event driven investing, the results of the Fund's operations can be expected to fluctuate from period to period.

*Activist Strategies:* Activist strategies are highly specialized, require devotion of substantial resources and usually involve relatively long investment horizons. The activist investing market is competitive and some of the going-private and leveraged buyout opportunities that the Fund may explore may be pursued by larger or better known investors, including private equity firms, LBO firms and other investment funds. There can be no assurance that the Fund will be able to identify or successfully pursue such opportunities in this environment. The Fund competes with many firms that may have substantially greater financial resources, more favorable financing arrangements and larger research staffs than are available to the Fund.

The Fund acting either alone or in conjunction with others, may acquire a "control" position in an issuer's securities. This 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. Some of the activist tactics that may be used involve litigation, which may be at the expense of the Fund. The Fund could be a party to lawsuits either initiated by it, or by a company in which the Fund

invests, or by other investors, or state or federal government bodies. There can be no assurance that any such litigation would be resolved in favor of the Fund.

Additionally, in the event the Fund, acting alone or as part of a group, acquires beneficial ownership of more than 10% of a certain class of securities of a public company, or places a director on the board of directors of such a company, the Fund may be subject to certain additional reporting requirements and may be required to disgorge certain short-swing profits arising from purchases and sales of such securities. In addition, in such circumstances the Fund will be prohibited from entering into a short position in such issuer's securities, and therefore limited in its ability to hedge such investments or implement a strategy or investment by another Trading Team. Other considerations and regulatory requirements may apply to substantial acquisitions of securities outside of the United States.

*Board Participation:* From time to time Trading Teams or the Fund may be able to place representatives on boards of certain companies in connection with Fund investments. While such representation may result in enhanced sale values of the investments, it may also prevent the Fund from freely disposing of its investments and may subject the Fund to additional liability. The Fund may indemnify any person for any claims arising from such board representation. Paloma Management or the applicable Portfolio Manager will attempt to balance the advantages and disadvantages of such representation when deciding whether and how to exercise the Fund's rights with respect to such companies, but the exercise of such rights could produce adverse consequences.

*Insider Status:* From time to time Paloma Management or a Portfolio Manager, or members of a group of investors or managers with which Paloma Management or a Portfolio Manager is acting, may work with the management team of a company in which the Fund has invested or proposes to invest in order to design an alternate strategic plan and assist them in its execution, and may secure the appointment of persons selected by Paloma Management or the Portfolio Manager, or other members of the group to the company's management team or board of directors. In the course of such activities, Paloma Management or a Portfolio Manager may come into possession of material, non-public information concerning such company, and the possession of such information may limit the ability of the Fund to buy or sell the securities issued by such company.

*Hedging Transactions:* The success of the Fund's hedging strategy will depend, in part, upon the ability to correctly assess the degree of correlation between the performance of the instruments used in the hedging strategy and the performance of the portfolio investments being hedged. Since the characteristics of many securities change as markets change or time passes, the success of the hedging strategy will also be subject to the ability to continually recalculate, readjust and execute hedges in an efficient and timely manner. While hedging transactions may be entered into with the intent to reduce risk, such transactions may result in poorer overall performance for the Fund than if such hedging transactions were not entered into. For a variety of reasons, Paloma Management or a Portfolio Manager may not seek to establish a perfect correlation between the hedging instruments utilized and

the portfolio holdings being hedged. Such an imperfect correlation may prevent the Fund from achieving the intended hedge or expose the Fund to risk of loss.

*Highly Volatile Markets:* The prices of securities can be highly volatile. Price movements of forward and other derivative contracts in which the Fund's assets may be invested are 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. Although market volatility can create trading opportunities, too much volatility may create additional risks that affect the ability of managers to put on and maintain effective hedges. It can cause the correlation between long positions and hedges to diverge, with the hedge having the opposite effect of that intended.

*"Widening" Risk:* For reasons not necessarily attributable to any of the risks enumerated herein (for example, supply/demand imbalances or other market forces), the prices of the securities in which the Fund invests may decline substantially. In particular, purchasing assets at what may appear to be "undervalued" levels is no guarantee that these assets will not be trading at even more "undervalued" levels at a time of valuation or at the time of sale. It may not be possible to predict, or to hedge against, such "spread widening" risk.

*Securities of Non-U.S. Companies:* Investments in securities of non-U.S. issuers have a range of other risks which may 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. In addition, 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 may also be less government supervision and regulation of exchanges, brokers and issuers than there is in the United States, and the Fund may have greater difficulty taking appropriate legal action in non-U.S. courts. Non-U.S. markets also have different clearance and settlement procedures which in some markets have at times failed to keep pace with the volume of transactions, thereby creating substantial delays and settlement failures that could adversely affect the Fund's performance.

Transaction costs of investing in non-U.S. securities markets are generally higher than in the United States, and securities denominated or whose prices are quoted in non-U.S. currencies also pose currency exchange risks (including blockage, devaluation and non-exchangeability).

*Developing or Emerging Markets:* Any of the Fund's investment strategies may be executed in developing or emerging markets. In addition to the risks for securities of non-U.S. companies, 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, restrictions on capital movement, etc.



Other risks related to developing or emerging markets include:

- *Access to Markets:* Some emerging markets have securities markets to which foreign investors have only limited direct or indirect access, or which may require approvals or consents. In addition, there is in some countries a higher possibility of nationalization, expropriation or confiscatory taxation, political changes, government regulation, social instability or diplomatic developments (including war) or terrorism which could adversely affect the economies of such countries or the Fund's investments in those countries. These limitations and events may interfere with and/or delay the pricing or trading of securities in emerging market countries for significant periods of time.
- *Currency Risk:* The economies, the currencies and the financial markets of a number of the emerging markets to which the Fund may be exposed have historically experienced extreme volatility, exposing investments in the markets of those countries to greater than usual risk.
- *Trading Volume; Transparency:* Trading volumes on the securities exchanges of emerging markets can be substantially less than in the developed world, so that executing trades may be slow and cumbersome, and may result in transactions at unfavorable prices. There may be no approved settlement procedure, and trades may be settled by a free delivery of stock with payment of cash in an uncollateralized manner, potentially exposing the Fund to counterparty credit risk. In general there may be an increased risk of defaults and delays in settlement compared to the markets in more developed economies. Volatility of prices can be greater than in the developed world.
- *Emerging Markets Banking and Financial Systems; Inflation:* The banking and other financial systems of many emerging markets are not all well developed or well regulated. Bank transfer delays, liquidity crises and other problems may arise as a result of the under-capitalization of the banking sector as a whole. Some emerging markets countries in which the Fund may invest have experienced substantial rates of inflation in recent years. Inflation and rapid fluctuations in inflation rates have had, and may in the future have, negative effects on the economies and securities markets of certain emerging economies.
- *Legal and Tax Systems:* The legal and tax systems of many emerging markets are less predictable than most legal systems in countries with fully developed capital markets. Currently, the tax rules and regulations prevailing in many emerging markets are, as a general matter, either new or under varying stages of review and revision, and there is considerable uncertainty as to whether new tax laws will be enacted and, if enacted, the scope and content of such laws. Reliance on oral administrative guidance from regulators and procedural inefficiencies hinder legal remedies in many areas, including bankruptcy and the enforcement of creditors' rights. There can be no assurance that current taxes will not be increased or that additional sources of revenue or income, or other activities, will not be subject to new taxes, charges or similar fees in

the future. In addition, changes to tax treaties (or their interpretation) with countries in which the Fund invests may have significant adverse effects on the Fund's ability to efficiently realize income or capital gains. With respect to certain countries, there is a possibility of expropriation, confiscatory taxation, imposition of withholding or other taxes on dividends, interest, capital gains or other income, limitations on the removal of funds or other assets of the Fund, and political or social instability or diplomatic developments that could affect investments in those countries.

#### *INSTRUMENTS TRADED - RISKS*

*Convertible Securities:* Convertible securities are exposed to changes in the price of the security into which they are convertible, changes in the creditworthiness of the issuer, changes in interest rates, and changes in overall fixed-income risk premiums. There is a risk that pricing inefficiencies may not materialize or that the securities have no relationship to each other.

*Fixed Income Securities and Loans:* The Fund may invest in debt securities, bonds or other fixed income securities and loan instruments of U.S. and non-U.S. sovereign and corporate issuers that pay fixed, variable or floating rates of interest. The value of fixed income securities and loans in which the Fund may invest may change in response to fluctuations in interest rates and/or to perceptions of creditworthiness, political stability or soundness of economic policies. These fluctuations may be more acute with respect to high yield and distressed issuers. The value of fixed income securities can also be impacted by dealer and market liquidity, particularly in periods of significant financial market stress. Certain fixed income securities purchased for the Fund will be non-performing and possibly in default. Furthermore, the obligor or relevant guarantor may also be in bankruptcy or liquidation.

Evaluating credit risk for debt securities involves uncertainty because credit rating agencies throughout the world have different standards, making comparisons across countries difficult. Also, the market for credit spreads is often inefficient and illiquid, making it difficult to accurately calculate discounting spreads for valuing financial instruments. It is likely that a major economic recession could disrupt severely the market for such securities and may have an adverse impact on the value of such securities. In addition, it is likely that any such economic downturn could adversely affect the ability of the issuers of such securities to repay principal and pay interest thereon and increase the incidence of default for such securities.

*ABS and MBS:* The investment characteristics of asset-backed securities ("ABS") and mortgage-backed securities ("MBS") differ from traditional debt securities. Among the major differences are that interest and principal payments are made more frequently, usually monthly, and that the principal may be prepaid at any time because the underlying loans or other assets generally may be prepaid at any time. Generally, mortgage obligors tend to prepay their mortgage loans when prevailing mortgage rates fall below the interest rates on their mortgage loans. Particular investments may experience outright losses, as in the case of an interest only security in an environment of faster actual or anticipated prepayments. Most commercial mortgage loans underlying MBS are effectively nonrecourse obligations

of the borrower, meaning that there is no recourse against the borrower's assets other than the collateral. ABS present certain risks that are not presented by MBS. Primarily, these securities do not have the benefit of the same security interest in the related collateral. There is a possibility that recoveries on repossessed collateral may not, in some cases, be available to support payments on these securities. The risk of investing in ABS is ultimately dependent upon payment of consumer loans by the debtor. The value of an ABS is affected by changes in the market's perception of the asset backing the security and the creditworthiness of the servicing agent for the loan pool, the originator of the loans or the financial institution providing any credit enhancement, as well as by the expiration or removal of any credit enhancement.

*Distressed and High Yield Securities:* The Fund may invest in "below investment grade" securities and obligations of issuers in weak financial condition, experiencing poor operating results, having substantial capital needs or negative net worth, facing special competitive or product obsolescence problems, including companies involved in bankruptcy or other reorganization and liquidation proceedings. Among the risks inherent in investments in troubled companies is the fact that it may be difficult to obtain information as to the true condition of such issuers. Such investments may also be adversely affected by laws relating to, among other things, fraudulent transfers and other voidable transfers or payments, lender liability and the bankruptcy court's power to disallow, reduce, subordinate or disenfranchise particular claims. Such companies' securities may be considered speculative, and the ability of such companies to pay their debts on schedule could be affected by adverse interest rate movements, changes in the general economic climate, economic factors affecting a particular industry or specific developments within such companies. There is no assurance that a Portfolio Manager will correctly evaluate the value of the assets collateralizing the loans or the prospects for a successful reorganization or similar action. In any reorganization or liquidation proceeding relating to a company in which the Fund invests, the Fund may lose its entire investment, may be required to accept cash or securities with a value less than the Fund's original investment and/or may be required to accept payment over an extended period of time.

In addition, the Fund may invest in bonds of issuers, often troubled issuers, that do not have publicly traded equity securities, making it more difficult to hedge the risks associated with such investments. Further, debt securities of troubled companies may not pay interest or dividends, whether inherently or by reason of default, whereas healthier issuers typically will pay interest or dividends on their debt securities.

*Bankruptcy Claims:* The Fund may invest in bankruptcy claims, which are amounts owed to creditors of companies in financial difficulty. Bankruptcy claims typically are illiquid and generally do not pay interest, and there can be no guarantee that the debtor will ever be able to satisfy the obligation on the bankruptcy claim. The markets in bankruptcy claims are not generally regulated by Federal securities laws or the U.S. Securities and Exchange Commission. Because bankruptcy claims are frequently unsecured, holders of such claims may have a lower priority in terms of payment than certain other creditors in a bankruptcy proceeding. In addition, under certain circumstances, payments and

distributions may be reclaimed if any such payment is later determined to have been a fraudulent conveyance or a preferential payment.

*Commodities, Futures and Certain Derivative Investments:* The prices of commodities contracts and derivative instruments, including futures and options, are highly volatile. Payments made pursuant to swap agreements may also be highly volatile. Price movements of commodities, futures and options contracts and payments pursuant to swap agreements are 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. The value of futures, options and swap agreements also depends upon the price of the commodities underlying them. In addition, the Fund's assets are also subject to the risk of the failure of any of the exchanges on which its positions trade or of its clearinghouses or counterparties. 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. If a counterparty defaults under a swap agreement, the value of the swap transactions with such counterparty can be expected to decline, perhaps to zero, potentially resulting in losses by the Fund. Paloma Management may take into account its view on the likelihood of default by a counterparty when determining the fair market value of transactions underlying swap agreements with that counterparty.

*Credit Default Swaps ("CDS"):* CDS are credit derivative contracts where one party (the buyer of protection) pays a premium to another party (the seller of protection) until the earlier of an agreed maturity or the date of a credit event. If a credit event occurs, the seller of protection is obligated to remit to the buyer of protection a certain payout. Credit events may include a failure by the reference company to pay principal or interest with respect to the reference obligation, a restructuring of the final maturity date of the reference obligation, an acceleration of the reference obligation so that it is due prior to its stated maturity date, a ratings downgrade of the reference obligation below certain specified ratings levels or a writedown (including an implied writedown) of the reference obligation. If a counterparty defaults under a swap agreement, the value of the swap transactions with such counterparty can be expected to decline, perhaps to zero. The settlement mechanism for the credit default swap market is comparatively new and may not operate efficiently at times of market stress which could result in significant losses to the Fund.

*Put Options:* There are risks associated with the sale and purchase of put options. The seller (writer) of a put option which is covered (e.g., the writer has a short position in the underlying security) assumes the risk of an increase in the market price of the underlying security above the sales price (in establishing the short position) of the underlying security plus the premium received, and gives up the opportunity for gain on the underlying security if the market price falls below the exercise price of the option. The seller of an uncovered put option assumes the risk of a decline in the market price of the underlying security below the exercise price of the option. The buyer of a put option assumes the risk of losing its entire investment in the put option.

*Call Options:* The seller (writer) of a call option which is covered (e.g., the writer holds the underlying security) assumes the risk of a decline in the market price of the underlying security below the purchase price of the underlying security less the premium received, and gives up the opportunity for gain on the underlying security above the exercise price of the option. The seller of an uncovered call option assumes the risk of a theoretically unlimited increase in the market price of the underlying security above the exercise price of the option. The securities necessary to satisfy the exercise of an uncovered call option may be unavailable for purchase, except at much higher prices, thereby reducing or eliminating the value of the premium. Purchasing securities to cover the exercise of an uncovered call option can cause the price of the securities to increase, thereby exacerbating the loss. The buyer of a call option assumes the risk of losing its entire premium investment in the call option.

*Futures Contracts:* The Fund may trade futures contracts that reference a wide variety of equity indices, government bonds, commodities and other underlying instruments and indices on futures exchanges regulated by the Commodity Futures Trading Commission ("CFTC") and other regulatory organizations. Futures contracts are levered because of the limited margin typically required for futures traded on an exchange. Futures positions can be volatile and may become illiquid. Certain futures exchanges limit fluctuations in certain futures contract prices during a single day by regulations referred to as "daily limits." Under these daily limits, during a single trading day no trades may be executed at prices beyond the daily limits, which may result in futures positions becoming illiquid, reducing the Fund's ability to liquidate unfavorable positions. It also is possible that an exchange or the CFTC may suspend trading in a particular contract, order immediate liquidation and settlement of a particular contract, or order that trading in a particular contract be conducted for liquidation purposes only. The prices of futures are highly volatile.

*Forward Contracts:* Forward contracts and options thereon, unlike futures contracts, are not traded on exchanges and are not standardized; rather, banks and dealers act as principals in these markets, negotiating each transaction on an individual basis. Forward and "cash" trading is substantially unregulated; there is no limitation on daily price movements and speculative position limits are not applicable. The principals who deal in the forward markets are not required to continue to make markets in the currencies or commodities they trade and these markets can experience periods of illiquidity, sometimes of significant duration. There have been periods during which certain participants in these markets have refused to quote prices for certain currencies or commodities or have quoted prices with an unusually wide spread between the price at which they were prepared to buy and that at which they were prepared to sell. Disruptions can occur in any market traded by the Fund due to unusually high trading volume, political intervention or other factors.

*Exchange Rate Fluctuations; Currency Considerations:* While the Fund will operate in U.S. Dollars, the Fund's assets will often be invested in non-U.S. securities and any income or capital received 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.

*Investments in Private Companies:* The Fund may invest in private companies, including 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. Such companies may face intense competition, including competition from companies with greater financial resources, more extensive development, better marketing and service capabilities and a larger number of qualified management and technical personnel. Such risks may adversely affect the performance of such investments and result in substantial losses.

Some of the companies that the Fund invests in may have substantial debt, which in turn will increase the exposure of such companies to adverse economic factors such as downturns in the economy or deterioration in the conditions of such companies or their respective industries. In the event any such company cannot generate adequate cash flow to meet debt service, the Fund may suffer a partial or total loss of capital invested in the company.

*Illiquid Portfolio Instruments:* The Fund may invest part of its assets in investments that Paloma Management believes either lack a readily assessable market value or should be held until the resolution of a special event or circumstance. Paloma Management may (or may not) decide to designate them as Special Situation Investments. The Fund may not be able to readily dispose of Special Situation Investments and, in some cases, may be contractually prohibited from disposing of such investments for a specified period of time. The sale of restricted and/or illiquid securities often requires more time and may result in higher brokerage charges than does the sale of more liquid securities. The limited liquidity of these investments may subject them to more extensive fluctuations in value and may impair the ability of the Fund to exit such investments. Companies whose securities are not publicly traded generally will not be subject to public disclosure and other investor protection requirements applicable to publicly-traded securities. Illiquid positions also may be difficult to value and such valuation may require the exercise of substantial discretion by Paloma Management.

Special Situation Investments and other assets and liabilities for which no market prices are available will generally be carried on the books of the Fund at fair value (which may be cost) as reasonably determined by Paloma Management. There is no guarantee that fair value will represent the value that will be realized by the Fund on the eventual disposition of the investment or that would, in fact, be realized upon an immediate disposition of the investment. A withdrawing investor with an interest in a Special Situation Investment will not receive any amount in respect of such interest (and fee expense reserves may be held back from the withdrawal proceeds paid to it) until a liquidating event has occurred in respect of the related Special Situation Investment.

*Investments in Standalone Funds:* The Fund may make investments in Other Investments that are standalone funds. Such investments may be illiquid, offering limited opportunities to withdraw. Withdrawals of capital from such funds typically require providing a notice of withdrawal several months in advance, and may have other significant limitations on the ability to withdraw, such as “lock-up” provisions (limiting the ability to withdraw for a certain period of time), “gate” provisions (limiting the amount that may be withdrawn at any one time) or the ability to “side pocket” all or a portion of the Fund’s investment (which cannot be withdrawn until the applicable fund removes the withdrawal restriction).

The Portfolio Managers of standalone funds act independently and Paloma Management has no rights other than those provided to the Fund as an investor in the fund. In addition, Paloma Management may have limited or no information about the actual securities held by a standalone fund at any given time. A standalone fund may use investment strategies that differ from its past practices and are not fully disclosed and that involve risks that are not anticipated by Paloma Management. The standalone funds may have limited operating history and Portfolio Managers may have limited experience in managing assets.

#### *OPERATIONAL RISKS*

*Trade Errors:* Given the volume of transactions executed by the Trading Teams and Paloma Management on behalf of the Fund, investors should assume that trading errors will occur and that the Fund will both benefit from any resulting gains and be responsible for any resulting losses. Trading errors might include, for example, the purchase or sale of a security in the wrong amount or key stroke errors that occur when entering trades into an electronic trading system. Paloma Management has established policies and procedures for the handling of trade errors that require that errors be corrected as soon as practicable after discovery. Paloma Management will determine in good faith whether or not the applicable Trading Team or Paloma Management entity will be required to reimburse the Fund for a trade error’s resulting loss pursuant to the standard of care stated in the applicable agreement that governs the Trading Team’s or Paloma Management entities’ activities on behalf of the Fund. In making this determination, Paloma Management will have a conflict of interest if determining whether a trade error should be attributed to the account of the Fund or to a Paloma Management entity, and will attempt to resolve such conflict by an objective determination of the status of such trade error under the applicable standard. The Paloma Management entities’ agreements, including their exculpation and indemnification provisions, are described in more detail under “Management and Administration,” but generally, Paloma Management will be free from liability for its actions, except in the case of fraud, gross negligence or reckless or intentional misconduct. Generally, in determining whether there gross negligence was involved in a trade error, Paloma Management will evaluate and consider the adequacy of the supervisory procedures in place to prevent such errors from recurring with any frequency.

*Leverage and Financing Risk:* The Fund may leverage its capital to seek to achieve a higher rate of return and may pledge its 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. The amount of borrowings which the Fund may have outstanding at any time may be substantial in relation to its capital. While leverage presents opportunities for increasing the Fund's total return, it has the effect of potentially increasing losses as well. Further, if the securities pledged to brokers to secure the Fund's margin accounts decline in value, the Fund could be subject to a "margin call," pursuant to which the Fund must either deposit additional funds or securities with the brokers, or suffer mandatory liquidation of the pledged securities to compensate for the decline in value. In the event of a sudden drop in the value of the Fund's assets, the Fund might not be able to liquidate assets quickly enough to satisfy their margin requirements. The forced liquidation of all or a portion of the Fund's portfolio at distressed prices could result in significant losses to the Fund.

*Change in Margin Terms:* In the absence of specific agreements, securities margin arrangements are generally subject to change or revocation by the lender upon very limited notice and for any or no reason. The lender may demand an increase in the collateral, including requiring collateral equal to the full amount of the borrowings, and, if the Fund is unable to provide additional collateral, the lender could liquidate assets held by the lender to satisfy the Fund's obligations. Liquidation in that manner could have extremely adverse consequences, which may be exacerbated in the event that these changes or revocations are imposed suddenly or by multiple lenders.

*Loss or Insufficiency of Margin on Derivatives:* The Fund engages in derivative transactions pursuant to ISDA master agreements ("ISDAs") with counterparties that are usually major banks or their affiliates. Under the Fund's ISDAs, counterparties may require the Fund to post initial margin at the time of entry into a derivatives transaction, and the initial margin represents an uncollateralized credit risk to the counterparty. Also, the ISDAs provide for two-way variation margin pursuant to which the Fund and the Fund's counterparty post margin to one another to reflect fluctuations in the market value of the derivative. Generally, the dealer bank is responsible for calculating the daily change in margin requirements to be paid by either party due to changes in market prices. However, the dealer bank's calculation, due to error or lack of timely data, may not accurately reflect such market price changes. Although the Fund has the right to dispute the dealer bank's calculation, there can be no guarantee that these dispute mechanisms would work effectively leaving the Fund materially under-collateralized. Further, since the variation margin amount is calculated on the day preceding any dealer default, it is unlikely to reflect fully the cost to the Fund of entering into a replacement transaction on the date of the default, particularly because any default by a dealer bank can have a significant effect on the markets and value of such transactions. As a result, any margin held by the Fund will likely prove insufficient in the case of a major dealer default.

*Net Asset Value Triggers:* The trading agreements, such as ISDAs, to which the Fund is a party, typically include terms relating to declines in the Fund's net asset value, measured as decrease in the Fund's net asset value by a specified percentage on a monthly, quarterly and/or annual basis ("NAV Triggers"). While a decline in the Fund's net asset value may be the result of a number of factors, including market conditions, withdrawals and/or diminishing performance, NAV Triggers provide a mechanism for the



Fund's counterparties and prime brokers to take protective measures to limit exposure to the Fund during a period of decline or volatility. Such protective measures may include requesting additional collateral, imposing other limitations on the Fund's ability to effect trades, closing out the Fund's positions under the relevant agreement on the counterparty's side of the market and at prices determined by the counterparty, setting off other amounts owed by the counterparty or terminating the relevant trading agreement(s). Further, a termination of an ISDA or a declaration of default by a counterparty also may permit other counterparties to exercise similar rights against the Fund under the cross-default and/or cross-acceleration provisions of other ISDAs and financing agreements. Any of these events could result in substantial losses to the Fund or have an adverse effect on the Fund's ability to trade and carry out its investment strategy.

*Repurchase Agreements:* The use of repurchase and reverse repurchase agreements by the Fund involves certain risks. For example, if the buyer of securities from the Fund under a repurchase agreement defaults on its obligation to sell back the underlying securities to the Fund, as a result of its bankruptcy or otherwise, the Fund will seek to obtain such securities elsewhere, which could involve costs or delays, and the price of the underlying securities may be greater than the repurchase price agreed to by the defaulting buyer. If the buyer becomes insolvent and subject to liquidation or reorganization under applicable bankruptcy or other laws, the Fund's ability to obtain the underlying securities may be restricted. It is possible, in a bankruptcy or liquidation scenario, that the Fund may not be able to substantiate its interest in the underlying securities.

*Commodities Futures and Options Margin:* Because of the limited initial margin required for, and substantial volatility associated with, the purchase or sale of most listed commodity futures contracts or commodity options, the Fund may be required to deposit a substantial amount of additional variation margin, on short notice, in order to maintain their positions. If it fails to do so, its positions may be liquidated at a loss, making the Fund liable for any resulting deficit. Under the U.S. Commodity Exchange Act, as amended, futures commission merchants are required to maintain customers' assets in a segregated account, but the Fund will nevertheless be subject to a risk of loss if a futures commission merchant fails to do so and becomes bankrupt.

*Margin in Periods of Stress:* In periods of market stress, and particularly in periods of stress specific to the Fund, lenders or counterparties may attempt to increase margin levels. Additionally, a simultaneous, broad-based increase in margin among hedge funds generally would likely adversely impact the investments held by the Fund by decreasing demand and increasing supply of those or similar investments.

*Cash Deposit Risk:* In order to limit credit risk to prime brokers and other custodians and to manage liquidity, the Fund currently maintains cash deposits with major banks. As these are large deposits, any failure of a deposit bank will have a material adverse effect on the Fund. The Fund may use money market funds as part of its cash management. The Fund therefore may be exposed to the risk that money market funds fail to return fully the principal invested.

*Non-U.S. Custodians, Brokers and Counterparties:* Some of the Fund's relationships are with custodians or counterparties that are organized outside of the U.S. or use affiliates that are organized outside the U.S. The Fund's assets therefore may be subject to bankruptcy protection that is different from or worse for creditors than U.S. bankruptcy treatment, or it may be unclear how applicable laws interact with U.S. law. Non-U.S. brokerage commissions generally are higher than in the United States. Increased custodian costs as well as administrative difficulties (such as the applicability of foreign laws to foreign custodians in various circumstances, including bankruptcy, ability to recover lost assets, expropriation, nationalization and record access) may be associated with the maintenance of assets in non-U.S. jurisdictions.

*Master-Feeder Structure:* PPLLC generally invests through the Master Fund in a "master-feeder" structure. Significant withdrawals from the Master Fund will increase the *pro rata* share of the operating expenses allocated to PPLLC and its investors which will result in lower returns. Significant withdrawals may also adversely impact the investment program and cause PPLLC to become more concentrated in certain strategies or securities.

*General Political, Economic, Legal, Tax and other Regulatory Risks:* The Fund's investments may be adversely affected by changes in economic conditions or political events, such as a stock market break, acts of terrorism, the outbreak of hostilities involving the United States, the death of a major political figure, a serious pandemic, or a natural disaster, among many others. Other factors, such as changes in federal or state tax laws, federal or state securities laws, bank regulatory policies or accounting standards, may make certain investments less desirable or may make certain investment strategies less effective. Similarly, legislative acts, rulemaking, adjudicatory or other activities of governmental or quasi-governmental bodies, agencies and regulatory organizations may make the business of the Fund less attractive. Laws and regulations, particularly those involving taxation, investment and trade, applicable to the Fund's activities can change quickly and unpredictably, and may at any time be amended, modified, repealed or replaced in a manner adverse to the interests of the Fund. In particular, in response to significant recent events in international financial markets, governmental intervention and certain regulatory measures have been or may be adopted in certain jurisdictions, including restrictions on short selling of certain securities in certain jurisdictions. The extent to which the underlying causes of these recent events are pervasive throughout global financial markets and have the potential to cause further instability is not yet clear. These recent events, and their underlying causes, are likely to be the catalyst for changes in global financial regulation for some time, and may result in major and unavoidable losses to the Fund.

The Fund may take positions with respect to certain tax issues that depend on legal conclusions not yet resolved by applicable legal authorities. Should any such positions be successfully challenged by the U.S. Internal Revenue Service (the "IRS") or other applicable taxing authority, there could be a material adverse effect on the Fund, and an investor may be found to have a different tax liability for that year from that reported on its federal income tax return.

With respect to certain countries, there is a possibility of expropriation, confiscatory taxation, imposition of withholding or other taxes on dividends, interest, capital gains or other income, limitations on the removal of funds or other assets of the Fund, political or social instability or diplomatic developments that could affect investments in those countries. An issuer of securities may be domiciled in a country other than the country in whose currency the instrument is denominated. The values and relative yields of investments in the securities markets of different countries, and their associated risks, are expected to change independently of each other.

The SEC, other regulators, and self-regulatory organizations and exchanges are authorized to take extraordinary actions in the event of market emergencies, the extent to which the Fund, Paloma Management and others may in the future be regulated, and the effect of such regulations, are unknowable.

The Fund and Paloma Management also may be subject to regulation in jurisdictions in which they engage in business. Because the Fund's business is dynamic and is expected to change over time, the Fund may be subject to new or additional regulatory constraints in the future. This Memorandum cannot address or anticipate every possible current or future regulation. Such regulations may have a significant impact on investors or the operations of the Fund. Paloma Management may, in its sole discretion, cause the Fund to be subject to such regulations if it believes that an investment or business activity is in the Fund's interest, even if such regulations may have a detrimental effect on one or more investors. Additional regulatory requirements will likely subject the Fund to increased administrative or transaction costs.

Any of the foregoing legal, regulatory and tax risks could give rise to material liabilities in periods after the occurrence of the transactions or other events giving rise to the claim. Consequently, such liabilities could be borne by investors who were not invested in the Fund at the time of such transactions and who did not derive any financial returns associated with such transactions.

#### *RISKS RELATED TO OTHER INVESTMENTS*

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

*Liquidity Risk:* Investments in Other Investments 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 Other Investments.

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

*Fraud or Mismanagement:* The portfolio manager, the administrator of an Other Investment (or any other person with access to an Other Investment's assets) could divert or abscond with the Other Investment'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 may have little or no means of independently verifying valuations of an Other Investment.

*Risk of multiple levels of fees and expenses:* Through the Fund's investment in an Other Investment, 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 an Other Investment.

## **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 principals 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 and as an 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 and Incentive 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.

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<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 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 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 generally 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 the 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.

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 Portfolio Managers, 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 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. Trade 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.

#### *Reports to Clients*

Investors receive monthly statements and portfolio reports, periodic letters and annual financial statements audited by an independent public accounting firm.

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

PPMC, TAM or the Fund may enter into arrangements with third parties whereby such third parties receive fees (from TAM – not the Fund) for introducing investors to the 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 Feeder 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’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.

Other Investments 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.