

Paloma Partners Management Company

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This brochure (the “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 the Chief Compliance Officer at (203) 861-8405. PPMC is registered as an investment adviser with the United States Securities and Exchange Commission (“SEC”) pursuant to the Investment Advisers Act of 1940, as amended (the “Advisers Act”). Registration with the SEC does not imply a certain level of skill or training and 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; (iii) a complete discussion of the strategies, risks, or conflicts of interest associated with any Fund; 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 relevant Fund Documentation.

Capitalized terms not otherwise defined herein are explained in **DEFINED TERMS**. Additional information about PPMC is 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**

**CPP FUND:** The CPP Feeder Funds (Capital Preservation Partners L.L.C. (“CPP”) and Capital Preservation Partners Limited (“CPPL”)) and the master fund, Capital Preservation Fund L.L.C. (“CPF”), collectively.

**FEEDER FUNDS:** The Paloma Feeder Funds and the CPP Feeder Funds.

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

**FUNDS:** Collectively, the Paloma Fund and the CPP Fund (each a “Fund”).

**PALOMA ADVISORS:** Paloma Partners Advisors LP, an investment adviser relying on PPMC’s investment adviser registration with the SEC.

**PALOMA FUND:** The Paloma Feeder Funds (Paloma Partners L.L.C. (“PPLLC”), Paloma International Limited (“PIL”) and Paloma Offshore Limited (“POL”)) and the master fund, Paloma International L.P. (“PILP”), collectively.

**PALOMA MANAGEMENT:** Collective term for PPMC and Paloma Advisors, except as the context otherwise requires, for instance where the context concerns only one entity but not the other. Except with respect to the application of PPMC’s policies and procedures, or as otherwise noted, references to Paloma Management do not include the Trading Teams (defined below) employed by PPMC.

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

**PORTFOLIO FUNDS:** External investment funds in which the Funds invest.

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

**SEC:** U.S. Securities and Exchange Commission.

**TAM:** Trust Asset Management, LLP, the predecessor entity to Paloma Advisors.

**TRADING TEAMS:** Trading Teams that are either engaged as independent contractors by a Fund and are responsible for their own operations (e.g., hiring of personnel and information technology), or employed by PPMC to advise a Fund. Descriptions of Trading Teams and their activities in this Brochure apply to each arrangement with Trading Teams (regardless of whether or not a Trading Team is an independent contractor or employee) unless otherwise noted.

#### **ITEM 4 – ADVISORY BUSINESS**

The responses to this Brochure combine information about PPMC as a registered investment adviser and Paloma Advisors as a Relying Adviser, unless specifically noted otherwise or as the context may require, for instance where the circumstance is unique to one entity but not the other.

PPMC is a Delaware corporation formed in 1989 and has its principal place of business in Greenwich, CT. PPMC is owned equally by S. Donald Sussman, Douglas Ambrose, Heather Garson, Gregory Hayt, Paul Kukuruzza, Gavin Morrocu and Randall Tam. Mr. Sussman and Mr. Hayt are PPMC's Directors. PPMC currently provides discretionary investment advisory services to the Paloma Fund and administrative services to the Funds.

Paloma Advisors is a Delaware limited partnership formed in 2014 as the successor entity to TAM, which was a US Virgin Islands limited liability partnership established in 2001. Paloma Advisors has its principal place of business in Florida. Mr. Sussman and Paloma Advisors' managing partner, Paloma Partners Advisors Inc., a Delaware Corporation (formerly a U.S. Virgin Islands corporation) owned and controlled by Mr. Sussman, own 100% of Paloma Advisors. Paloma Advisors is a Relying Adviser with respect to PPMC's investment adviser registration with the SEC ("Relying Adviser") pursuant to the SEC's Division of Investment Management staff guidance issued in a no-action letter dated January 18, 2012, in response to the American Bar Association's request for interpretive guidance (the "ABA No-Action Letter").

Mr. Sussman currently provides discretionary investment advice to the Funds through Paloma Advisors and has been providing investment advice to private investment funds since 1981. As of December 31, 2014, PPMC managed \$2.3 billion on a discretionary basis (the assets under management of the Paloma Fund) and Paloma Advisors managed \$2.6 billion on a discretionary basis (the total combined assets under management of the Funds).

#### ***THE PALOMA FUND***

The Paloma Fund is a multi-manager, multi-strategy hedge fund which has no material limitations on the investment instruments, markets or countries in which it may invest. Paloma Management has ultimate discretion and control over the Paloma Fund and its investments. Its responsibilities to the Paloma 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 Paloma Fund's exposures as it deems appropriate. Investment advice is provided to the Paloma Fund pursuant to the terms of the Fund Documentation; investors in the Paloma Fund cannot obtain services tailored to their specific needs.

PPMC provides investment advisory services to the Paloma Fund separate and apart from Paloma Advisors, but subject to Paloma Advisors' and ultimately Mr. Sussman's authority.

The Paloma Feeder Funds invest substantially all of their capital through a “master-feeder” structure in PILP, the master fund. PPLLC is a feeder fund organized for the benefit of U.S. taxable investors, PIL is organized as a feeder fund for the benefit of non-U.S. investors and tax-exempt U.S. investors, and POL is organized as a feeder fund for the benefit of non-US investors (as of the date of this Brochure POL does not have any investors). The investment programs of PPLLC, PIL and POL are primarily carried out through PILP, and almost all of PILP’s trading activities are carried out through its primary trading subsidiary, Sunrise Partners Limited Partnership. The Paloma Feeder Funds may also invest a portion of their assets directly, and indirectly through PILP, in Portfolio Funds.

PPMC provides investment advisory services to the Paloma Fund in its capacity as: a special member of PPLLC, a service provider to PIL and POL, and as a general partner of PILP and Sunrise Partners Limited Partnership. Paloma Advisors provides investment advisory services to the Paloma Fund in its capacity as: the managing member of PPLLC, the trading advisor to PIL and POL, and as a general partner of PILP and Sunrise Partners Limited Partnership.

Paloma Management seeks to balance the overall risk profile of the Paloma 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 Paloma Fund’s strategies and Portfolio Managers, and makes the capital allocation and risk management decisions for the Paloma Fund. Capital of the Paloma Fund is allocated directly and indirectly through PILP among a diverse group of strategies executed by Portfolio Managers who are either Trading Teams or Portfolio Funds; the majority of the Paloma Fund’s capital is managed by Trading Teams. However, Paloma Management also trades for the Paloma Fund, primarily for hedging purposes.

The Paloma 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 Paloma Fund’s balance sheet, and not through separate accounts, Paloma Management has transparency, ongoing liquidity, and ultimate control over the Paloma Fund’s capital used by Trading Teams which enables it to risk manage the Fund and allocate capital among strategies.

PPMC also facilitates the operations of, and implements certain controls for, the Paloma Fund including:

- Portfolio risk management;
- Granting trading discretion (Trading Teams are authorized to trade, but not exercise custody over the Paloma Fund’s capital, e.g. move cash or securities);
- Approving, managing, negotiating and monitoring the Paloma Fund’s counterparty, prime brokerage, custodial and financing arrangements;
- Managing the Paloma Fund’s risk exposure to prime brokers and counterparties;

- Controlling the Paloma Fund’s leverage in consultation with Paloma Advisors;
- Reviewing (in consultation with Paloma Advisors) the valuations of the Paloma Fund’s positions which are valued by the Paloma Fund’s administrator in accordance with PPMC’s pricing procedures;
- Ongoing due diligence reviews of Portfolio Managers;
- Accounting and administration (including managing the Paloma Fund’s relationship with its administrator);
- Providing tax, legal documentation, compliance, investor relations services, and information technology (including managing the Paloma Fund’s relationship with its third-party technology service provider) to the Paloma Fund; and
- Employing Trading Teams on behalf of the Paloma Fund, whose services are governed by the terms of their employment agreements with PPMC.

As set out in ITEM 5, PPMC does not directly receive a fee for its services to a Fund. Instead, the operating expenses of PPMC are passed through to the Funds.

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. Trading Teams that are engaged as independent contractors are responsible for their own operations (e.g., hiring of personnel and information technology), and Trading Teams employed by PPMC are subject to the direct supervision and control of PPMC. Portfolio Funds are responsible for their own operations and regulatory compliance obligations. The day-to-day activities of Portfolio Funds are generally external to the risk management and organizational control of Paloma Management. However, Paloma Management regularly reviews performance and strategy information (including daily position level information with respect to the largest Portfolio Fund investment) provided by Portfolio Funds.

#### *THE CPP FUND*

The CPP Fund is a “fund-of-funds” that typically invests in Portfolio Funds executing a variety of investment strategies. There are no diversification requirements or material limitations on the investment instruments, markets or countries in which the CPP Fund may invest. The CPP Fund seeks capital appreciation with low volatility and pursues this investment objective by investing in Portfolio Funds. The CPP Fund is not currently marketed to new investors.

Paloma Advisors provides discretionary investment advisory services to the CPP Fund. CPP is a feeder fund organized for the benefit of U.S. taxable investors that invests substantially all of its capital through a “master-feeder” structure in CPF, the master fund. CPPL, which also invests substantially all of its capital in CPF, is organized as a feeder fund for the benefit of non-U.S. investors and tax-exempt U.S.

investors. The investment programs of CPP and CPPL are primarily carried out through CPF. CPF currently invests a portion of its assets in the Paloma Fund.

Paloma Advisors is the Managing Member of CPF and CPP, and is the trading advisor to CPPL. Paloma Advisors provides investment advice to the CPP Fund pursuant to the terms of the Fund Documentation. Investors in the CPP Fund cannot obtain services tailored to their specific needs. PPMC provides certain administrative support services to the CPP Fund.

#### **DISCLAIMER**

No guarantee or representation is made that any 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 and risks that may be greater than forecasted, especially in unusual market conditions. Nothing herein is intended to imply that a Fund's investment strategy is "conservative", "safe", "risk free", or "risk averse". There can be no assurance that a 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.

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



## ITEM 5 – FEES AND COMPENSATION

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 Management Fee or the Incentive Fee, as applicable, the compensation and benefits of PPMC’s employees, expenses related to the investment activities of a 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 a Fund, and with respect to PIL, POL and CPPL, the cost of the offshore administrator and board of directors. Expenses are deducted periodically in advance or arrears.

*PALOMA FUND:* Set out below is a chart indicating the types of fees and expenses borne by each Class of Interests or Shares in a Paloma Feeder Fund. Each such fee or expense is described in further detail below.

	Class A	Class B	Class C	Class D
Management Fee	X	X		
Incentive Fee			X	X
PPMC Expenses	X	X	X	X
Portfolio Manager Expenses (including incentive fees)	X	X	X	X
Liquidity Capital Account//NAV Reduction		X		X
Administrative and Operating Expenses	X	X	X	X

*CPP FUND:* The fees and expenses borne by the CPP Fund include the Management Fee, PPMC Expenses, Portfolio Manager Expenses (including incentive fees) and Administrative and Operating Expenses, defined below. The CPP Fund’s expenses also include the cost (compensation, benefits and other business related expenses) of an employee of Paloma Advisors who provides services exclusively to the CPP Fund.

- **MANAGEMENT FEE AND INCENTIVE FEE**

*Management Fee:* Paloma Advisors is generally entitled to receive a management fee, monthly in arrears, from each holder of Class A or B Interests/Shares in a Paloma Feeder Fund equal to 1/12 of 1.5% (1.5% annualized) of each such investor’s capital account balance or net asset value, as applicable (“Management Fee”). The Management Fee to which Paloma Advisors is generally entitled is calculated in the same manner for interests/shares in each CPP Feeder Fund.

*Incentive Fee:* Paloma Advisors 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) from each holder of Class C or D Interests/Shares in a Paloma Feeder Fund in an amount equal to 20% of the net realized and unrealized capital appreciation attributable to such an investor's capital account balance or net asset value, as applicable.

Each Fund's administrator calculates the amount of the applicable Management Fee or Incentive Fee. The Management Fee or the Incentive Fee may be subject to fee waivers with respect to particular investors (as described further below under "FEE WAIVERS/REDUCTIONS").

- *PPMC EXPENSES AND OTHER OPERATING AND ADMINISTRATIVE EXPENSES*

The expenses of PPMC (such as salaries, bonuses and benefits paid to PPMC employees – including Trading Teams employed by PPMC – and other overhead, operating and administrative expenses of PPMC) are passed through to, and paid for or reimbursed by, the Funds. These expenses are significant and create less of an incentive for PPMC to reduce its expenses (including compensation expenses) than would be the case if all or some of its expenses were not passed through to investors but rather had to be covered by a "fixed" fee with respect to the services provided. PPMC maintains policies and procedures which seek to address this conflict.

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

A Fund's ongoing operating expenses include PPMC's office, general administrative, overhead and other operating costs or expenses incurred in providing services to a Fund. The expenses for the Chief Compliance Officer and other compliance related expenses (e.g. legal and consulting advice) related to Paloma Advisors', PPMC's, or a Fund's compliance requirements, including regulatory filings and registration/membership fees, are passed through to the Funds.

Expenses which may be passed through to a Fund 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 employees;
- Consultants, subcontractors, agents, professional advisors, and recruiters;
- Computer hardware, software and other equipment including telephones and smart phones;

- Reference materials, research services, data feeds, and industry publications;
- Facilities (including leases for office space) 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 herein;
- Directors' and officers' insurance and errors and omissions insurance, if any; and
- Any other fees and expenses incurred in connection with any transactions, engagement, or other agreements entered into by a Fund, PPMC or Paloma Advisors on behalf of a Fund including, among other things, the costs and expenses of third party administrators and Trading Teams employed by PPMC to advise a Fund.

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

- *PORTFOLIO MANAGER EXPENSES*

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

*Trading Team Compensation:* Trading Teams that are independent contractors will generally receive a management fee and performance-based compensation while Trading Teams that are employees of PPMC will generally receive a salary and bonus which may be discretionary or calculated on the basis of performance as described below.

- *Independent Contractors:* The calculation methodology for management fees and performance-based compensation paid to Trading Teams varies by Trading Team. The management fee 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 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.

- *Employee Trading Teams:* The salary received by an employee Trading Team is generally treated as an advance against the bonus due to that Trading Team and will be set-off against bonus amounts otherwise payable. The amounts available for bonus to employee Trading Teams may be reduced by expenses incurred by PPMC in connection with the performance of the Trading Team's duties and for amounts paid on behalf of, or costs of services provided to, the Trading Team by PPMC or the relevant Fund(s).

If a Trading Team provides advice to more than one Fund, Paloma Management will allocate the management fee (or salary and expenses in the case of employee Trading Teams) to the relevant Funds using an allocation methodology it believes to be fair and reasonable.

Performance-based compensation is generally calculated based on a percentage of a Trading Team's net profits as of each calendar year-end (or such other calculation period as set forth in the relevant investment management agreement) 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 relevant fund(s).

The CPP Fund may, but does not typically, engage the services of Trading Teams. If the CPP Fund does engage Trading Teams in the future, the terms of such arrangements would likely be similar to the terms described herein.

*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 a Fund is negative. If a Portfolio Manager suffers net losses during the year, the losses are generally carried forward and past losses generally 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 performance-based compensation from prior years.

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

Class B and Class D investors in the Paloma Fund 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

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<sup>1</sup> Investors in PIL and POL 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.

the relevant capital account balance. The Liquidity Capital Account Reduction will be credited on a pro rata basis to the capital account balances of investors electing an annual withdrawal cycle up to the amount of the Management Fee or Incentive Fee (as applicable) and non-trading related expenses. Any excess Liquidity Reduction is payable to Paloma Advisors.

The Liquidity Capital Account Reduction is applied monthly in arrears.

- *FEE AND EXPENSE RESERVES*

If after giving effect to a withdrawal, an investor would be completely withdrawn from a 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).

- *HEDGE CURRENCY SHARE CLASSES*

Investors in non-US dollar share classes will bear the costs incurred in connection with hedging the applicable 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 utilized by the relevant Fund for its investment program).

- *COMPENSATION RECEIVED FROM OTHER FUNDS*

The Funds currently invest (or intend to invest), and may in the future invest, in other vehicles from which Paloma Advisors, Mr. Sussman, or an affiliate is entitled to receive compensation. In the event that a 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 Management Fee or 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) a “Fund’s Investment Amount” means the amount of capital invested or committed by a Fund in the Other Fund upon which the Other Fund calculates its management fees.

Other Funds may charge higher overall fees than the Funds charge, which may result in a conflict of interest in determining whether or not to invest a Fund’s assets in the Other Funds. That conflict of interest is discussed further in ITEM 6 below.

- *FEE WAIVERS/REDUCTIONS*

A Fund, with the consent of Paloma Advisors, may elect to reduce, waive, calculate differently, or provide rebates on:

- (i) The Paloma Advisors' Management Fee or the 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 with respect to certain investors in a Paloma Feeder 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).

A Fund's Administrative and Operating Expenses (described above) cannot be waived, reduced, calculated differently or rebated (except in accordance with the Liquidity Capital Account Reduction) for any investor.

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

Paloma Advisors 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 Paloma Advisors 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 Paloma Advisors or a Portfolio Manager receiving greater performance-based compensation than would be the case if net appreciation was based only on realized gains.
- Paloma Advisors 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, Paloma Advisors 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. Paloma Advisors and Portfolio Managers maintain policies and procedures that seek fair allocation of time and investment opportunities among all clients.
- Performance-based compensation may encourage Paloma Advisors or a Portfolio Manager to overvalue assets in order to increase the amount of its performance-based compensation.

*Investments in Other Funds:* The Funds currently invest, and may in the future invest, in Other Funds from which Mr. Sussman is entitled to a portion of the fees charged by the Other Funds (such as the China Funds discussed further in ITEM 10). Mr. Sussman will waive, or cause to be waived, the portion of the Management Fee or 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. Other Funds may, however, charge higher fees than are charged by the Funds, which may result in a conflict of interest for Mr. Sussman when allocating a Fund’s assets to an Other Fund with higher fees. In that case, although Mr. Sussman will waive the fees to which he is entitled from the Funds, he could potentially receive a greater amount of compensation through his relationship with the Other Funds.

## **ITEM 7 – TYPES OF CLIENTS**

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

Interests in the Funds, and the Funds themselves, 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 Funds are offered exclusively to investors satisfying the applicable eligibility and suitability requirements either in private placement transactions within the United States or in offshore transactions. Investors in the Funds are also Qualified Eligible Persons as defined in the Commodity Exchange Act.

The minimum investment is generally \$5 million and may be waived in compliance with applicable law. The CPP Fund is not currently marketed to new investors.



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

### ***METHODS OF ANALYSIS AND INVESTMENT STRATEGIES***

The following is a summary of the strategies and methods Paloma Management and/or Portfolio Managers use in formulating advice or managing assets (and their material risks) for the Funds. 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 Funds 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, a 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 Funds 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 Funds will be achieved. Certain investment practices may increase the risk profile of the Funds. The Funds’ activities could result in substantial losses (including the complete loss of capital) under certain circumstances.

While Paloma Management currently expects that Portfolio Funds as well as the Funds, will primarily engage in these types of strategies, the Funds and Portfolio Funds may engage in investment strategies and trade in financial instruments that are not described in this Brochure. These descriptions do not in any way limit the Funds’ or Portfolio Funds’ investment activities.

*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.

*Credit Relative Value Investment Strategies* are designed to identify attractive long and short opportunities in corporate, asset backed and mortgage backed securities (including senior and subordinated claims as well as bank debt and other outstanding debt obligations). Managers seek to take advantage of idiosyncratic opportunities on both the long and short sides. Strategies may also have limited exposure to government, sovereign, equity, convertible or other obligations. Managers employ fundamental credit analyses focused on valuation, asset coverage and quality of collateral. In most cases portfolio exposures are concentrated in instruments which are publicly traded, albeit with varying degrees of liquidity.

*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 investments typically involve, but are not limited to, initial public offerings (after which time, the Funds' interests may be subject to transfer restrictions for periods of time) or private sales of the Funds' 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 and Paloma Advisors are not obligated to hedge any specific risk and may elect not to hedge against certain risks or to alter the extent to which the Funds are hedged from time to time.

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

## DISCLAIMER

The following is a summary of certain material risks associated with the types of securities that Paloma Management and/or Portfolio Managers primarily recommend to the Funds (or the Portfolio Funds in which the Funds invest). The information included below does not include every potential risk associated with each investment strategy or security. Investors and prospective investors in the Funds 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 Funds’ 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 Funds 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.

***Please refer to the relevant Fund Documentation for a more detailed discussion of risk factors as applicable to each Fund.***

### INVESTMENT AND TRADING RISKS – GENERALLY

- Highly Volatile Markets
- Prime Broker and Counterparty Risk
- Concentration of Investments
- No Fixed Strategy, Instruments, Markets, Sectors or Issuer Weightings
- Discretion of Paloma Management; New Strategies and Techniques
- Dependence on the Manager and Portfolio Managers
- Use of Leverage

## *INVESTMENT STRATEGY RISKS*

- Statistical Arbitrage and Systematic Futures (Algorithmic Strategies)
- Model-Based Trading
- Fundamental or Directional Investments
- Macro-Economic
- Short Selling
- Event Driven, Special Situations and Merger Arbitrage
- Activist Strategies
- Board Participation
- Insider Status
- Hedging Transactions
- Highly Volatile Markets
- “Widening” Risk
- Securities of Non-U.S. Companies
- Legal and Tax Systems
- Developing or Emerging Markets, which also may include the following other risks:
  - Access to Markets
  - Currency Risk
  - Trading Volume; Transparency
  - Emerging Markets Banking and Financial Systems; Inflation

## *RISKS RELATED TO INSTRUMENTS TRADED*

- Convertible Securities
- Fixed Income Securities and Loans
- ABS and MBS
- Distressed and High Yield Securities
- Bankruptcy Claims
- Commodities, Futures and Certain Derivative Investments
- Credit Default Swaps (“CDS”)
- Put Options
- Call Options
- Futures Contracts
- Forward Contracts
- Exchange Rate Fluctuations; Currency Considerations
- Investments in Private Companies
- Illiquid Portfolio Instruments
- Investments in Standalone Funds
- Use of Leverage

#### *OPERATIONAL RISKS*

- Trade Errors
- Leverage and Financing Risk
- Change in Margin Terms
- Loss or Insufficiency of Margin on Derivatives
- Net Asset Value Triggers
- Valuation
- In-Kind Distributions
- Lack of Investor Liquidity
- Significant Withdrawals/Redemptions
- Repurchase Agreements
- Commodities Futures and Options Margin
- Margin in Periods of Stress
- Cash Deposit Risk
- Non-U.S. Custodians, Brokers and Counterparties
- Master-Feeder Structure
- General Political, Economic, Legal, Tax and other Regulatory Risks

#### *RISKS RELATED TO PORTFOLIO FUNDS*

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

- Liquidity Risk
- Lack of Transparency
- Fraud or Mismanagement
- Valuation Risk
- Risk of multiple levels of fees and expenses

## **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

Each of PPMC and Paloma Advisors is a member of the National Futures Association (“NFA”), 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. Mr. Sussman is also registered with the NFA as a principal and as an Associated Person, of both Paloma Advisors and PPMC.

- *CHINA FUNDS AND CHINA MANAGERS*

The China Funds are 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 are managed by the China Managers (defined below). 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.

The China Managers include: 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. Additional information about the China Managers that advise the China Funds is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The China Managers manage the China Funds, in which the Paloma Fund invests a portion of its assets. Mr. Sussman effectively owns 50% of 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, the Paloma Fund invests in the China Funds which results in Mr. Sussman being entitled to compensation from both the Paloma Fund and the China Funds for the same capital (i.e., double fees), a conflict further described above in ITEM 6. However, as described below, Paloma Advisors waives the Management Fee and the Incentive Fee in respect of the Paloma 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 PAAMCO.

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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.



- *OTHER INVESTMENT ACTIVITIES*

Investment Persons<sup>3</sup> 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 clients. For example, Investment Persons may give advice and take action in the performance of their duties to one client which may differ from the timing and nature of action taken with respect to a Fund or Portfolio Fund. These other activities may affect the prices and availability of the securities and other financial instruments in which a Fund or Portfolio Fund invests.

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 of the Funds in a way that protects each Fund's interests.

- *BOARD MEMBERSHIPS*

Investment Persons may serve as directors of companies in which a Fund or Portfolio Fund invests. In addition to any fiduciary duties owed to a Fund or Portfolio 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 a Fund or Portfolio Fund. Investment Persons serving as directors may receive non-public information as a result of their duties and such knowledge may restrict a Fund's ability to buy or sell securities of the relevant company.

- *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 Funds).

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<sup>3</sup> For the purpose of this Item 10, the term "Investment Persons" includes Paloma Advisors, PPMC, Portfolio Managers and their respective employees, officers and directors.

- 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 Funds are treated fairly and that Investment Persons act in the best interests of a Fund (see, for example, Paloma Management's allocation procedures, as described below).

The Funds currently invest, and may in the future invest, in Other Funds in which Mr. Sussman is entitled to a portion of the fees charged by the Other Funds (such as the China Funds). Conflicts related to these investment are described in ITEM 6 and above in this ITEM 10 under "China Funds and China Managers".

- *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 a 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 other Feeder Funds. Paloma Management or 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*

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

- *AGGREGATION OF TRADE ORDERS*

In the case that trades are executed on behalf of multiple clients, and if portfolio decisions are made contemporaneously for multiple clients in the same instrument, Paloma Management and/or Trading Teams may, if consistent with market conditions, client characteristics, and applicable law, bunch or aggregate client orders for execution. These bunched or aggregated orders might facilitate execution and may reduce brokerage and other costs. Paloma Management and/or Trading Teams, however, are not required to bunch or aggregate orders if portfolio management decisions are not made contemporaneously, if Paloma Management and/or Trading Teams determine that it would be consistent with its investment management duties or the interests of its clients not to do so, or if bunching or aggregating is not practical operationally or otherwise.

Because of prevailing trading activity, it is frequently not possible to receive the same price or execution on the entire volume of positions purchased or sold in such bunched or aggregated orders. When this occurs, Paloma Management and/or Trading Teams (in its sole and absolute discretion) may charge or credit clients participating in the bunched or aggregated order with the average price of the various prices received for that order, or alternatively, may charge or credit such clients with a price determined in good faith to be an appropriate price. Positions purchased or sold in a bunched transaction are allocated to the participating clients using methods determined by Paloma Management and/or Trading Teams in its sole discretion (which methods may include *pro rata* by assets under management or by proportionate order size). Paloma Management and/or Trading Teams may, however, increase or decrease the transaction amount allocated to each client if necessary to avoid holding odd-lots or small numbers of positions for particular clients. If Paloma Management and/or Trading Teams are unable to or does not fully execute a bunched transaction or Paloma Management and/or Trading Teams determines that it would be impractical to allocate a small number of positions among all of the accounts initially intended to participate in the transaction, Paloma Management and/or Trading Teams may allocate such positions in a manner determined in good faith to be an appropriate allocation. Although it is anticipated that the bunching or aggregation of orders will benefit each client overall, aggregating orders may disadvantage clients, including without limitation by resulting in shared allocations of orders or worse execution prices for client orders. Alternatively, not aggregating orders may disadvantage clients, including without limitation by resulting in higher costs or worse execution prices for client orders.

Although it is anticipated that any bunching or aggregation of orders will benefit each client overall, aggregating orders may disadvantage clients, including by resulting in shared allocations of orders or higher execution prices for clients. Alternatively, not aggregating orders may disadvantage clients, including by resulting in higher costs (including higher execution prices) for client orders.

- *LETTERS OF UNDERSTANDING A/K/A "SIDE LETTERS"*

By entering into side letters, certain investors in a Fund may receive information that is not generally requested or utilized by other investors in a 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 a Fund are generally available to all investors in that Fund.

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

The Code of Ethics applicable to the Funds provides a standard of conduct for, among other things, the personal trading of Access Persons. Access Persons must 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 generally prohibited from participating in initial public offerings and executing transactions in issuers included on PPMC's Restricted List. Certain employees including Mr. Sussman also must obtain preapproval from the 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, Paloma Management and/or their 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 a Fund. In the event that a conflict of interest arises, Paloma Management will seek to resolve such conflicts in a fair and equitable manner.

Investors and prospective investors in the Funds may obtain a complete copy of the Code of Ethics free of charge by submitting a written request to the Chief Compliance Officer, Heather Garson, at Two American Lane, Greenwich, CT 06831 or by phone at (203) 861-8405.

- *EXPENSES*

Investors and prospective investors should note that Paloma Management may have a conflict with respect to controlling their expenses, as the Fund Documentation does not limit the amount of expenses that the Funds may pay, advance or reimburse.

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

Paloma Management believes that its expense allocation procedures provide an objective methodology for allocating expenses among the Funds, 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 a Fund in entities managed by their 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 Funds 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 Funds or clients to lower fees and expenses.

Trading Teams have established, and may in the future establish, one or more funds which may or may not also be Portfolio Funds. In such instances, the Paloma Fund typically receives a share in the management fees and performance-based compensation generated from those funds. Such interests may be in the form of a special class of shares or limited partnership interest in the fund (or an affiliated fund), or a contractual agreement with the fund (or an affiliated fund) or its management company.

Paloma Management may affect cross transactions between Funds, provided that: such transactions are consistent with the investment objectives and policies of such Funds; are, in the view of Paloma Management, favorable to both sides of the transactions; and are otherwise executed in accordance with applicable laws, rules and regulation.

The Funds do not, but may in the future, engage in principal 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

For the purpose of this ITEM 12, and unless otherwise specifically noted, the term “Portfolio Managers” includes Paloma Management and Trading Teams.

Portfolio Managers have 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. However, PPMC reviews, approves and monitors the creditworthiness of prime brokers, executing broker-dealers and counterparties used by Trading Teams. Prime brokers, executing broker-dealers and counterparties are chosen by Trading Teams in consultation with 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 Funds (and not Paloma Management) bear all of the expenses related to their own operations. Therefore, the use of soft dollars does not result in any expense shifting between Paloma Management.

In selecting brokers and dealers to effect portfolio transactions, Portfolio Managers may consider the full range of quality of the broker’s service in selecting brokers to meet best execution obligations and may not pay the lowest commission rates or prices available. The following are some factors that contribute to efficient execution, although Portfolio Managers are not required to weigh any of these factors equally:

- 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, a 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 Paloma Fund may be introduced to potential investors interested in investing through “capital introduction” events sponsored by a Fund’s prime brokers. Neither Paloma Management nor any Fund compensates any prime broker for organizing the events or for investments in a 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 a 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 a Fund (or a Portfolio Fund in which a 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 a Fund.

To the extent that a 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 the Safe Harbor provided in 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 a 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.

*Aggregation Of Trade Orders:* In the case that Paloma Management and/or Trading Teams execute trades on behalf of multiple clients, and if portfolio decisions are made contemporaneously for multiple clients in the same instrument, Paloma Management and/or Trading Teams may, if consistent with market conditions, client characteristics, and applicable law, bunch or aggregate client orders for execution. These bunched or aggregated orders might facilitate execution and may reduce brokerage and other costs. Paloma Management and/or Trading Teams, however, are not required to bunch or aggregate orders if portfolio management decisions are not made contemporaneously, if Paloma Management and/or Trading Teams determine that it would be consistent with its investment management duties or the interests of its clients not to do so, or if bunching or aggregating is not practical operationally or otherwise.

Although it is anticipated that any bunching or aggregation of orders will benefit each client overall, aggregating orders may disadvantage clients, including by resulting in shared allocations of orders or higher execution prices for clients. Alternatively, not aggregating orders may disadvantage clients, including by resulting in higher costs (including higher execution prices) for client orders.

*Trade Errors:* A Fund (and not Paloma Advisors, PPMC 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 a Fund, investors should assume that trading errors (and similar errors) will occur and that a Fund will be responsible for any resulting losses, even if such losses result from negligence.



## ITEM 13 – REVIEW OF ACCOUNTS

*PALOMA FUND:* 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 a 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 unaudited account statements, quarterly net asset value statements for the applicable Feeder Fund, monthly portfolio reports, periodic letters and annual financial statements audited by an independent public accounting firm.

*CPP FUND:* Paloma Advisors is responsible for all investment and redemption decisions for the CPP Fund. Portfolio monitoring is conducted on an ongoing basis through due diligence meetings, reviews of communications and other information about the Portfolio Fund.

- *Reports to Clients*

Investors receive monthly unaudited account statements, quarterly net asset value statements for the applicable Feeder Fund, quarterly portfolio reports, periodic letters and annual financial statements audited by an independent public accounting firm.

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

PPMC, Paloma Advisors or the Paloma Fund may enter into arrangements with third parties whereby such third parties receive fees, Management Fee waivers or rebates of the Management Fee for introducing investors to the Paloma Fund pursuant to a written agreement and in compliance with applicable rules and regulations.

The CPP Fund is not currently marketed to new investors.

## **ITEM 15 – CUSTODY**

To the extent required by applicable law, a Fund's securities and funds are held by qualified custodians. Investors in a Fund receive annual financial statements audited by an independent public accounting firm, within 120 days (Paloma Fund) and 180 days (CPP Fund) of the fiscal year end, for a Fund in which they have invested. Investors should carefully review these statements.

## **ITEM 16 – INVESTMENT DISCRETION**

PPMC and Paloma Advisors exercise discretion in managing the Funds based on a Fund's investment objectives, policies and strategies disclosed in the applicable Fund Documentation. PPMC's investment discretion is subject to Paloma Advisors' ultimate authority. Paloma Advisors typically assumes investment authority through its agreements with a Fund.

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

Pursuant to each Trading Team's investment management agreement, the Trading Team is generally granted the discretion to vote any proxies related to the relevant Fund's assets managed by that Trading Team. Trading Teams vote proxies in the best interest of the relevant Fund. Paloma Management will vote any proxies not voted by a Trading Team in accordance with the best interest of the relevant Fund(s).

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

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

## **ITEM 18 – Financial Information**

At this time, neither PPMC nor Paloma Advisors have information to report that is applicable to this ITEM 18.