Insights – Distressed Assets Q1 2014

Madoff – Happy 5th Anniversary?

At Multiplicity Partners, we help investors to solve their problems associated with the “long tail” of their impaired investments. In many private banking portfolios, the majority of such “legacy” positions are feeder funds linked to Madoff’s Ponzi scheme. What is the current status of these positions, five long years after Bernard Madoff was arrested?

Let’s start with the most important thing: **If you are exposed to Madoff’s fraud case, directly or indirectly via feeder funds, you must take action NOW.** The deadline for registering with the Madoff Victim Fund, a newly established recovery pool, is on **February 28, 2014**.

Madoff Victim Fund – a second recovery pool

The recovery of assets for the victims of the massive Madoff Ponzi scheme started in 2009 and is managed by the liquidator Irving Picard, who was appointed by the US Securities Investor Protection Corporation. In November 2013, a second recovery vehicle for Madoff investors was established by the US Department of Justice: the Madoff Victim Fund. Its purpose is to distribute funds directly to all victims of Madoff’s crimes and it is run separately from the liquidator’s initiative which distributes cash to individuals or fund vehicles that were directly registered with Madoff Securities. While Picard to date has recovered USD 10 billion, the Madoff Victim Fund presently holds USD 4 billion. The largest part of these assets was recovered through settlements with the Picower estate and JP Morgan.

The deadline for registering with the Madoff Victim Fund is on February 28, 2014 and most likely it will take several weeks for you to gather the necessary documentation and complete the formalities. If you act on behalf of clients, it is your fiduciary duty to take immediate action as there will be substantial and irrecoverable damage to the value of any Madoff feeder fund positions if you fail to properly file with the Madoff Victim Fund.

To date, most European Madoff investors have not seen a penny of the massive USD 10 billion of assets recovered by the Madoff liquidator Irving Picard, despite the fact that more than USD 5 billion (incl. advances of the US Securities Investor Protection Corporation) have already been distributed to direct investors and feeder funds in 2011 and 2013. In contrast to many US investors, most of Madoff’s European victims were only indirectly exposed to the fraud through feeder funds (Fairfield, Kingate, Thema, etc.). Most of these funds are still unable to distribute recovered amounts as they are involved in various legal disputes, in particular regarding claw backs, and thus resulting in a “dead-lock” situation. Unfortunately, we see little hope that many of these disputes are resolved in the near future. Some feeder funds set-up in Luxembourg seem to be totally obstructed as investor protection mostly exists just on paper, but is not enforced by the local courts. None of the service providers, such as the custody banks, have been held accountable for having acted grossly negligent so far.

The most important development for Madoff's European victims came just in time for the 5th anniversary of the revelation of the Ponzi scheme: On November 18, 2013, the Madoff Victim Fund announced to pay out USD 2.35 billion to Madoff's actual victims, i.e. the ultimate private beneficiaries behind all the layers of feeder funds and nominee bank accounts. With the settlement of charges against JPMorgan on January 7, 2014, the Madoff Victim Fund has accumulated a total of USD 4 billion to be distributed to Madoff's end investors. The distributions shall be made "as soon as practical", which usually means that it takes another few years.

Estimating the recovery value

Calculating the expected recoveries for investors and estimating the timing for (further) distributions is still extremely difficult as the outcome of many lawsuits is totally uncertain. The total loss incurred by victims of the Madoff fraud under the applicable net equity method is about USD 17.5 billion, which is far less than the aggregate of all reported Madoff account statements at the end of 2008 that included massive, but fictitious, profits. So far an astounding USD 14 billion or 80% of the net losses have been recovered by liquidating remaining assets, claiming back payouts of fictitious profits and through forfeitures in a range of legal actions.

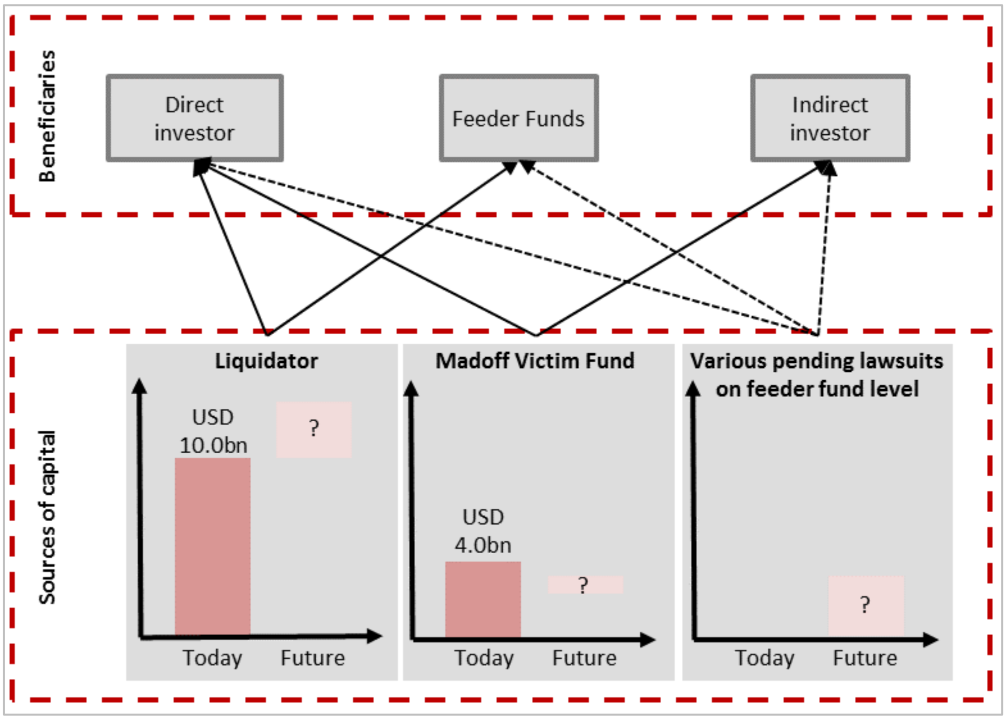

Figure 1: Sources of capital to recover the total loss of USD 17.5 billion

Calculating the claim

One very important aspect in the process of claiming your losses is obviously how they are calculated. Let us quickly illustrate how this is done under the net equity method (also referred to as “cash in/cash out” method) that is applied by the Madoff Victim Fund as well as the liquidator Irving Picard. Under this net equity method, a claim is calculated as any cash deposited by investors less all amounts withdrawn (and thereby eliminating false or fictitious profits as reported by Madoff). The Madoff Victim Fund further deducts distributions that were or will be made by the liquidator of the Madoff estate.

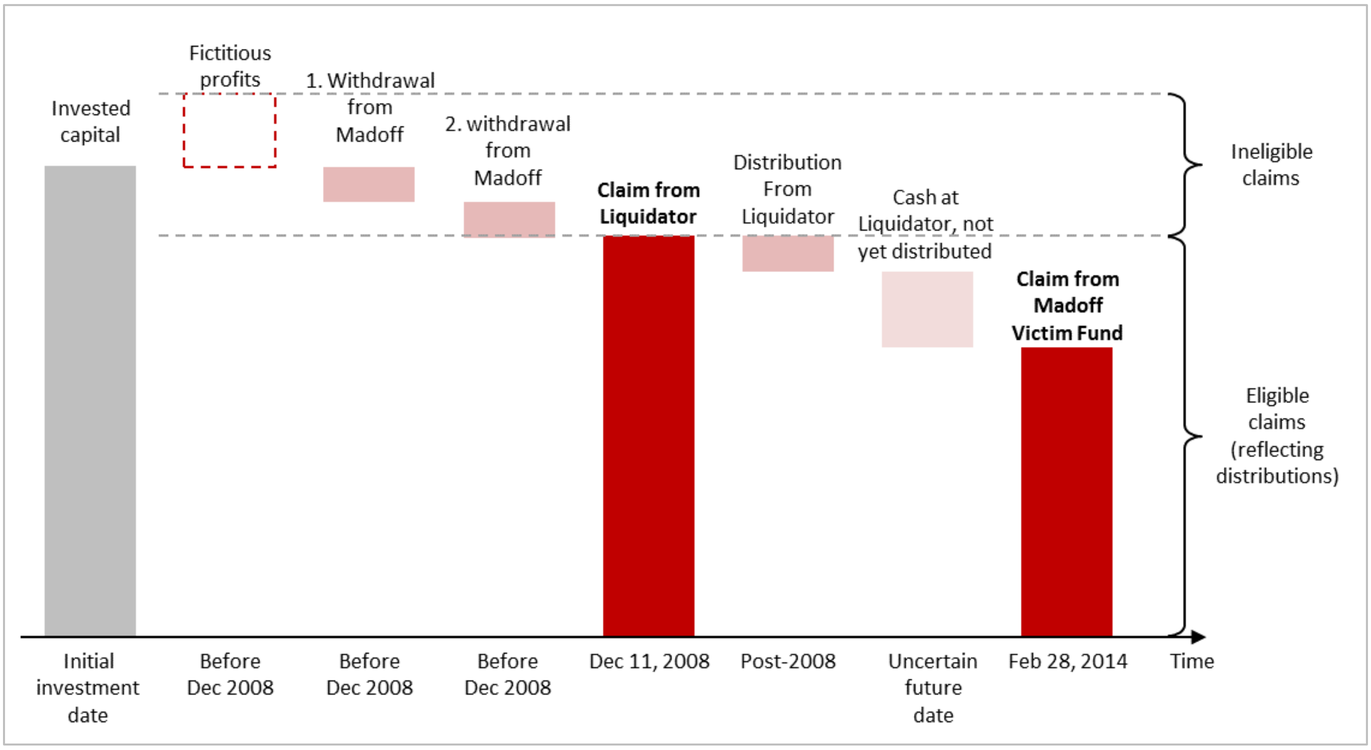

Figure 2: Illustrative example how to calculate the “actual loss” or claim amount

Note that if you have withdrawn more from your Madoff investments than your invested capital, then you are considered a “net winner” and are not eligible for compensation under the two main recovery programs. In contrast, net winners may face a risk of clawbacks by the liquidator or any of the pooling vehicles.

Reporting the claim

Let us now look at the practical steps that need to be taken. As mentioned above, you will need to act fast to assure participating in these substantial recovery distributions. The Madoff Victim Fund issued three different claim reporting forms considering a victim's relationship to Madoff Securities. Below we present an illustrative overview of who needs to file what form to the Madoff Victim Fund until February 28, 2014.

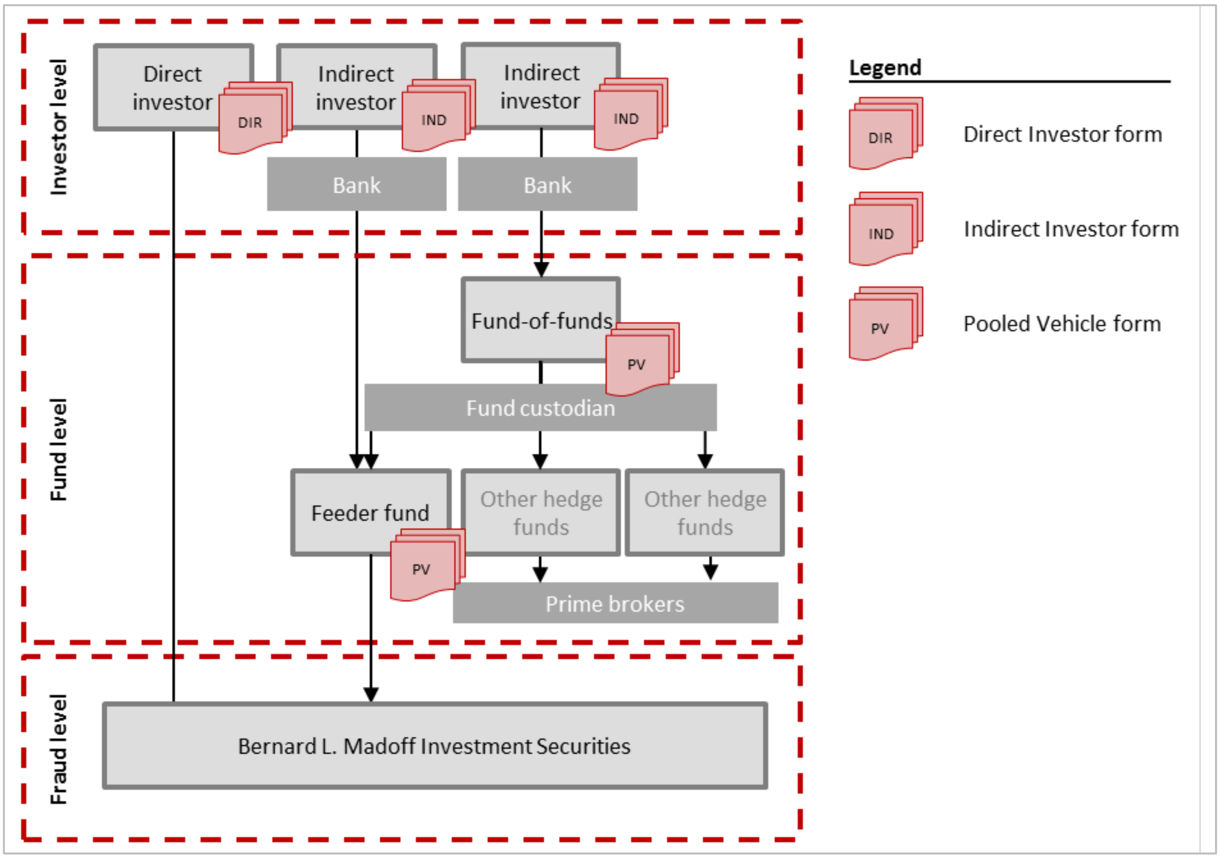

Figure 3: Investment layers and most relevant Madoff Victim Fund forms

The Madoff Victim Fund's form "DIR" is only for investors that had an account directly with Bernard L. Madoff Investment Securities. Form "IND" is more relevant for most Europeans victims as it relates to those investors that were exposed indirectly via feeder funds or fund-of-funds and, consequently, were several "layers" away from Madoff. The form "PV", for pooled vehicles, is to be filed by the management of the feeder funds or fund-of-funds that had some exposure to Madoff. Note that the Madoff Victim Fund requires you to back up much of the requested information by attaching copies of various account statements and investment reports. Multiplicity is happy to assist you in this process.

Making sure that your claim is properly filed is certainly worth the effort, although it might take years for the distributions to be completed. Should you consider selling your Madoff claims in the secondary market, you will most probably not get a decent price unless you have accurately documented and filed your net losses prior to the deadline.

Please do not hesitate to contact us with any questions you may have on the topic of Madoff investments, or any other impaired investments you may hold.

Thomas Ritter is a founding partner of Multiplicity Partners. He is responsible for the firm's distressed assets business and has more than 17 years of experience in alternative investment industry with focus on secondary markets, portfolio management and structuring. Prior to founding Multiplicity Partners, he held various roles at Horizon21, Man/RMF and Credit Suisse. Thomas holds a MSc in Finance from the ICMA Centre, University of Reading, and is a CFA and CAIA Charterholder

About Multiplicity Partners

Multiplicity Partners is an investment boutique specialised in providing liquidity solutions to holders of private market funds and distressed assets. The firm also offers a range of advisory and governance services across alternative assets.

Multiplicity Partners has been an active participant in the secondary market for fund interests and distressed assets since 2010, acting as buy- and sell-side advisor, investment manager and principal investor. The team has successfully completed dozens of transactions across a wide range of illiquid and complex financial assets and established a global network of industry contacts. Each partner contributes more than 15 years of relevant experience, giving us the collective capabilities to effectively identify, analyse and execute attractive investment opportunities in hard-to-value assets.

Multiplicity Partners is an independent and management-owned company. Personal accountability of senior professionals ensures quality of work, reliability and attention to details.

Multiplicity Partners is a member of the Financial Services Standards Associations (VQF), a self-regulatory organization in Switzerland pursuant to the Anti-Money Laundering Act – officially recognized by the Swiss Federal Financial Market Supervisory Authority (FINMA). The company is authorized by FINMA to distribute collective investment schemes to qualified investors in Switzerland. Multiplicity Partners is audited by PricewaterhouseCoopers (PwC), Switzerland.

Multiplicity Partners is a member of Invest Europe and an Associate Member of SECA (The Swiss Private Equity & Corporate Finance Association).

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