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Post Madoff: What Now For Investors?

Law360, New York (January 09, 2009) -- Those persons and entities that were direct or "indirect" investors with Bernard L. Madoff Investment Securities LLC have been confronted with a myriad of issues affecting their investments and recovering them. Investors in other hedge funds or investment funds who are anxious about their investments may wish to consider the following steps at this juncture.

1. Review any offering materials and private placement memorandum that were sent at the time of initial investment for a description of how the fund would be run, what it would invest in, how the fund managers were to be compensated and any compensation they received or were to receive from persons other than the investors.
2. Review subsequent reports from the fund manager for consistency with the original descriptions or any alterations in the original investment objectives and strategies.
3. Compare any interim or year-end reports of results of investments and the financial condition of the fund with the materials described above.
4. Review the audited financial statements and the auditors' reports of examination and, especially, the footnotes to those financials for indications of any deviations from the representations of the nature of the investments, risks, changes in investment strategies and signs of variances. Confirm that the auditor has sufficient resources and expertise to audit the firm.
5. Review Internet resources for statements by the fund's managers and advisors and measure those statements against what was told to the investors.
6. Determine whether, and at what point in time, key employees of the fund departed. What were their stated reasons for departing and what explanations were offered by the fund for the departures?

7. Review all periodic statements received by the investor from the fund to determine if investments were consistent with the representations made and the goals and risk assumption of the investor.

8. Make inquiry of the fund manager as to whether the securities (and cash) reflected on the monthly statements are held in a segregated account for the benefit of the particular investor. If not, ask where they are held.

If Securities Investor Protection Corporation (SIPC) insurance is available, determine whether the fund managers purchased any other insurance coverage for the benefit of the investors. If so, ascertain the identity of the carrier, the amounts of coverage, who must give notice to the carrier of a loss, and in what manner that notice must be given. Request a certificate of insurance.

9. Ask the fund managers to explain their investment strategies and concepts and how they have protected investment positions. Ask how much leverage is being employed in these strategies, how much of the portfolio is pledged to secure financing and what steps the manager is taking to reduce risk and exposure at this time.

10. Determine how much the fund retains in liquid, readily available funds to cover redemptions and whether that amount or percentage has been increased recently.

11. If the fund has a board, determine when the board last met, how frequently it meets, whether it reviews in detail the fund's cash and securities positions and its trading, risk, and/or due diligence strategies, and whether and how often it reviews those strategies with the fund's managers and traders. Request minutes from these meetings.

12. Some funds, such as Madoff's, have overseas operations that are set up as separate entities in foreign countries that are subject to the laws of those nations. If the US entity experiences difficulties, the foreign entity may find that local governments move in and take over the assets and operations of the foreign entity to protect their own nationals and sovereign interests.

Those assets may then be unreachable by US investors—at least without commencing an action in the foreign country, which would be governed by foreign law. Investors may want to determine if the fund in which they are invested has such offshore entities, and where and what the relationships are between the US and foreign entities.

Interested persons may want to seek legal counsel with respect to current or new fund investments to determine whether they may have a risk exposure domestically or abroad and what steps might be available to address those issues.

--By Marvin G. Pickholz (pictured), Jason R. Pickholz and David J. Kaufman, Duane Morris LLP

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