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Investment Manager & Fund Administrator – The Need for Separation

Two recent high-profile fund collapses in Luxembourg have awoken the fund hydra of conflict of interest, that “creature” that rears up when massive fund losses arise and hindsight is applied.

Stating the obvious, a fund comprises 5 basic functions – a board of directors to provide stewardship to the fund and its service providers, an investment manager to manage the assets as per the fund prospectus, the administrator to provide independent share valuations (NAV – Net Asset Value) on which shareholders invest or divest, the custodian to safeguard the funds assets and provide banking facilities, and finally the independent auditor to provide periodic 3rd party accounting of the funds operations and performance.

All common sense, and much practised as one of the key cornerstone of the fund industry. Indeed, the offshore fund industry has operated this strict policy for decades, prior to the adoption or regulation in the onshore markets. Yet time and time again this fundamental cornerstone is abused, and surprisingly the regulators who authorise funds turn a blind eye. As a result, a catastrophic loss of assets that can be traced to a conflict of interest often goes unpunished, since the regulator often provided the authorisation blessing in the first place. Let's see....

LFP I SICAV and LFP Prime SICAV families of sub-funds

Fund directors – founders of Luxembourg Fund Partners, the Investment Manager
Luxembourg Fund Partners, Investment Manager

Apex Fund Services (Malta), Fund Administrator, 18% shareholder in Luxembourg Fund Partner, providing 2 directors to Luxembourg Fund Partners.

Credit Suisse Nova (Lux), and Credit Suisse Virtuoso SICAV families of sub-funds

Fund directors – all Credit Suisse employees

Credit Suisse Fund Management, Investment Manager

Credit Suisse Fund Services (Luxembourg), Fund Administrator

If you are sitting uneasy at this point, you have good reason. For the LFP funds, the clear conflict of interest between Apex and Luxembourg Fund Partners was never declared, so investors never knew that the NAV calculation process was lacking in independence. PWC, the auditor to both the fund and the fund manager, knew about this conflict but failed to draw attention to it in the annual audits.

For the Credit Suisse funds, public name familiarity would grant some leeway with the structure, yet the lack of independent representation is startling. All 6 directors in October 2019 for both funds were from Credit Suisse Asset Management or Funds Management.

Collapse of the LFP funds

Since their launch in 2012/2013, 4 of the LFP I sub funds ultimately suffered massive fraud and collapsed with almost 100% losses. It is clear that the NAV's were mere wishful thinking – losses were hidden from investors for years, whilst unsuspecting investors, enticed by the monotonically increasing NAV per share each month, poured their money into these prize-winning funds. Of course, the investment manager and its shareholder fund administrator benefitted from these increasing management and performance fees, until, like all Ponzi schemes, the day of reckoning occurred and all went to zero.

The regulator, to date, has failed to act on the parties involved – partly because they continually overlooked the problems of the monthly liquidity fund lending for years with no interest etc., but partially because it granted the Chapter 15 management company licence to Luxembourg Fund Partners on the condition that Apex become a shareholder and participate in the management. Quite incredibly, the CSSF sowed the seeds of conflict of interest before the funds were even launched.

Collapse of the Credit Suisse funds

Whilst this story is still working its way through the courts and various shareholder class action suits, one thing can be sure – Tokio Marine gave notice of credit policy termination in September 2020, yet the funds remained open to new investors for 6 months, at unimpaired NAV value per share, before suspending March 2021 with a 50% writedown of the invested assets (all Luxembourg SPV issued securities). US\$ 3+ billion wiped out with an overnight markdown of future receivables... With not an ounce of independence to be had, a clear case of “Emperor's Clothing” fund management.

For the record, “Ponzi Scheme” definition

“A Ponzi scheme is a fraudulent investing scam promising high rates of return with little risk to investors. The Ponzi scheme generates returns for early investors by acquiring new investors. This is similar to a pyramid scheme in that both are based on using new investors' funds to pay the earlier backers.”

In the USA these schemes are litigated against most severely, by the SEC and Department of Justice, for the purposes of investor protection. The Racketeering legislation, or RICO, would most likely be applied to both fund groups in this story, yet the regulators pay little regard to such events, and more importantly, do little to ameliorate the situation.

Time for the European Commission and ESMA to step in and regulate the “unregulated”..

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