



UNION BANCAIRE PRIVÉE

Update on the Madoff fraud case Questions & Answers

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1. Who is Bernard Madoff?

- Bernard Madoff, a figure in the securities industry in the US, is the founder and majority shareholder of Bernard L. Madoff Investment Securities, LLC, a broker/dealer with USD 700 mn of equity capital registered with the SEC and FINRA, the successor agency to the National Association of Securities Dealers (NASD) where he served as vice chairman.
- He served as NASDAQ's chairman of the board of directors, and on its board of governors. He remained a member of the NASDAQ OMX Group Inc.'s nominating committee.
- Mr. Madoff has been active in the NASD, a self-regulatory organisation for the US securities industry.
- The firm was founded in 1960.
- His firm was one of the five most active firms in the development of the NASDAQ.

2. What is the structure of Bernard L. Madoff Investment Securities, LLC?

- Bernard L. Madoff Investment Securities LLC was a leading international market maker.
- The firm has been providing quality executions for broker-dealers, banks, and financial institutions since its inception in 1960.
- According to the Form ADV filed with the SEC on 1 July 2008, Bernard L. Madoff Investment Securities LLC managed USD 17 billion across 23 accounts (in investment vehicles).
- The media calculation that Madoff lost USD 50 billion is based on information within the US Attorney complaint. "MADOFF also stated that he estimated the losses from this fraud to be at least approximately USD 50 billion."
- The discovery process of ascertaining the exact amount of the loss and the nature of the fraud is still ongoing.

3. In which investment vehicles managed by Madoff did UBP clients invest?

- UBP clients' investments with Madoff were made mostly through four different investment vehicles with the following legal set ups, jurisdiction, auditors and regulatory oversights:

Ascot Fund Ltd

- **Incorporation:** Cayman Islands – 10 February, 1992
- **Regulatory Authority:** Cayman Islands Monetary Authority
- **Administrator:** Self-administrated
- **Auditor:** BDO Tortuga, Cayman Islands

Fairfield Sentry Ltd

- **Incorporation:** British Virgin Islands – 30 November, 1990
- **Regulatory Authority:** BVI Financial Services Commission
- **Administrator:** Citco Fund Services (Europe) BV, Amsterdam (the Netherlands)
- **Auditor:** PwC, the Netherlands



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M-Invest Ltd

- **Incorporation:** Cayman Islands – 23 January, 2003
- **Regulatory Authority:** Cayman Islands Monetary Authority
- **Administrator:** Citco Fund Services (Bermuda) Ltd, Bermuda
- **Auditor:** Ernst & Young, Cayman Islands

Kingate Euro Fund, Ltd

- **Incorporation:** British Virgin Islands – 19 April, 2000
- **Regulatory Authority:** BVI Financial Services Commission
- **Administrator:** BISYS hedge Fund Services Ltd, Bermuda
- **Auditor:** PwC, Bermuda

Madoff made all investment decisions and executed the trades while the investment vehicles were set up as separate entities and run by different individuals/service providers as listed above (among the 23 known investment vehicles), which themselves were clients of Madoff's broker/dealer operation. Essentially, these vehicles were used to gain exposure to Madoff's strategy. UBP initially invested through Ascot and Fairfield Sentry and subsequently through M-Invest.

4. What are the positions currently invested in Madoff investment vehicles across UBP Funds of Hedge Funds as at 1 November 2008?

Of the 22 funds of hedge funds advised by UBP, the positions allocated* to Madoff are the following:

Dinvest - Total Return	3.05%
Dinvest Concentrated Opportunities	2.31%
Dinvest - Select I	6.51%
Dinvest - Select II	6.32%
Dinvest - Select III	6.35%
Dinvest Concentrated Opportunities III Exquity	4.46%
UBP Multi-Strategy Alpha Fund (direct & indirect)	6.92%
TrendSquare I	2.90%
Selectinvest ARV	5.79%
Selectinvest ARV II	4.50%
Selectinvest ABF Ltd	3.91%
Selectinvest Multistrategy	0.00%
Selectinvest Multistrategy Advantage	0.00%
Selectinvest Event Driven	0.00%
Selectinvest Global Equity L/S	0.00%
Selectinvest Global Resources	0.00%
Selectinvest Focus Recovery	0.00%
Dinvest Concentrated Opportunities Distressed	0.00%
Dinvest - L/S US	0.00%
Dinvest Japan & Asia	0.00%
Dinvest - L/S Europe	0.00%
Dinvest Concentrated Opportunities II	0.00%

* The percentages above include the amounts put up for redemption at the end of November, which are now unfortunately considered at risk.



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5. What is the total amount invested through Madoff investment vehicles?

- The aggregated amount in the discretionary portfolios and fund of hedge funds products at UBP is around USD 700 mn.

6. Will the position be fully written down?

- We will take a write-down for our 30 November NAV across all portfolios but have not yet determined whether a full write-down is necessary as we will need to obtain feedback from the various administrators and auditors. However, given the situation, there is a high likelihood that a full write down might be required.

7. What was the underlying investment strategy followed by Madoff?

- The Madoff strategy was described as trading in the stock and options markets based on proprietary trading signals, coupled with Bernard Madoff's oversight.
- In more detail, the strategy was: (i) the purchase of a basket of long equities that were expected to highly correlate to the S&P 100 Index (known as the OEX); (ii) the simultaneous sale of an out-of-the-money call option on the S&P 100 with a notional value similar to that of the long equity portfolio; and (iii) the simultaneous purchase of an out of the money put option on the S&P 100 also with a notional value similar to the long equity portfolio. Each basket holds about 50 large capitalisation equities from the S&P 100, and the options traded are exchange-traded or over-the-counter-exchange-traded lookalikes. The split-strike conversion strategy was allegedly implemented 6-8 times per year and the investment cycle can range from 2-8 weeks. Between investment cycles, the funds' assets are invested in US Treasuries.
- The investment presented the opportunity to participate in a unique return stream that combined a split-strike option strategy with the market information of one of the world's largest market-makers in equity securities.
- In essence, the perceived edge was Madoff's ability to gather and process market-order-flow information and use this information to time the implementation of the split strike option strategy.

8. What was the key rationale for investing with Madoff?

- The reasons that led us to approve various investment vehicles for investment within the scope of our hedge fund mandates essentially relates to the perceived attractive investment opportunity offered and the highly recognized pedigree of the manager, Madoff, through his extensive reach and involvement in the financial services industry.
- From the outset, our analysts spent significant time understanding and following the strategy and the manager. Madoff's split-strike conversion strategy offered stable returns with a long and audited track-record. The downside to the strategy seemed very limited in the sense that around the core investment in S&P 100 stocks he sold out-of-the-money calls and used proceeds to buy out-of-the-money puts, thus creating a range which effectively limits both losses and profits. This strategy was therefore also very liquid.
- Furthermore, due to his significant volume size as a broker/dealer, we were assured that he had some visibility as to the momentum of the markets, allowing him to implement a bearish or bullish position within the parameters of the above-mentioned loss and profit limits. The outcome, proven by the long track record, audits and regulatory oversight, showed a compelling investment opportunity with stable returns, limited volatility and good liquidity, which we deemed appropriate to reduce overall volatility within a balanced portfolio.
- The various companies within the Madoff structure are regulated by the SEC, CFTC, FINRA as well as the FSA in the UK. These regulators performed regular audits with no material findings, contributing to our comfort with the manager, which was essential to approving the fund from a structural risk viewpoint.

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9. Consistency of returns: was it too good to be true?

- Madoff was not betting on markets going up or down.
- With his split-strike approach, his system told him when to activate it and the rest of the time he was only invested in US treasuries.
- Our expectation for the returns is largely what they have been because systematic strategy predicated on his position as a market maker, seeing market volume, having data going back over the years, having technology to produce signals to indicate when to get in and out.
- This strategy was not supposed to generate outsized returns but stable returns and a good proxy for the expected returns was 2-3 times the risk-free rate (high single digit).

10. What was the size of Madoff's business?

- Bernard L. Madoff Investment Securities, LLC had USD 700 mn of equity capital.
- Madoff had 200 employees, with 100 people in trading, 50 in technology, and 50 in the back office.
- 170 people in New York and 30 in London.
- Madoff securities represented +/-10% of NYSE trading volume.
- The auditors of the firm were Frierling & Horowitz (US) and KPMG (UK).
- 12 people are dedicated to the split strike conversion strategy, lead by Bernard Madoff.
- Bernard Madoff sat on many reputable boards (NASDAQ, Depository Trust and Clearing Corp., Securities Industry Association).

11. What about the non-segregation of investment management, executing broker and custodian functions?

- We identified this as a risk of the investment from a structural risk perspective but found comfort in two mitigating elements: his status as a large and reputable broker/dealer which was subject to routine SEC and FINRA regulatory audits and Madoff's longstanding reputation in building Wall Street's financial markets infrastructure (through his work with NASDAQ, the NSCC, and the DTCC).
- Madoff is a regulated broker/dealer executing trades and an investment advisor to the vehicles, thus it seemed to make sense that Madoff would have had the custody and be its own prime broker.
- The investment vehicles managed by Madoff were separate legal entities with their own administrator and auditor, all large and reputable firms as highlighted under the point 3 of this document. The auditors of the investment vehicles provided us with clean opinions and attestations of their annual verifications.

12. Was Madoff only getting paid on commissions?

- Madoff was predominantly a broker/dealer and as such was paid on commissions from the trades he was initiating and conducting.

13. And UBP's retrocession from Bernard Madoff Investment Securities LLC?

- UBP did not get any retrocession from Bernard Madoff Investment Securities LLC nor from the various investment vehicles managed by Madoff (as listed above).

14. What about Madoff's auditors?

- Madoff's auditors Frierling & Horowitz were accredited by the SEC and all the investment vehicles were audited by the largest auditing firms. Despite the supposedly size weakness of Madoff's auditors, the SEC has each year renewed its approval; SEC reports on the firm were regularly made available.



15. How was the NAV calculated?

- The Bank relied on the NAV calculation made by the third party funds to the extent this calculation was checked by the funds' administrators, custodians and auditors.
- Although Ascot had their NAVs calculated in house, it was possible to compare it against Fairfield Sentry's, M-Invest's and Kingate's which benefited from an independent calculation of NAV's.
- Regarding M-Invest, Citco as the administrator, received daily trade tickets and provided us with monthly statements and NAVs.

16. Did it seem unlikely that the S&P 100 options market that Madoff purported to trade could handle the size of the combined investment vehicles?

- Madoff traded all large cap stocks on the exchange (top 100) with a market cap close to USD 5 tn and an average daily volume of approximately USD 20 bn.
- He traded OTC options on the S&P 100 Index.
- Madoff was more focused on OTC derivatives so that you might not see a corresponding cover in the listed markets to his options. His counterparties were large financial institutions dealing under ISDA agreements.

17. What about due diligence and meetings over the years?

- Various due diligence visits were repeatedly conducted at different levels – Madoff, Fairfield and Ascot.
- Structural Risk Analysis considered the ongoing regulatory supervision of SEC and FINRA as mitigating factors. Madoff was SEC registered and reviewed twice a year. In addition to the broker dealer activity, Madoff's investment management activity has been registered with the SEC since 2006 when the SEC wanted to force all money managers to register; when the SEC lifted this constraint later on, Madoff did not de-register as many other managers did subsequently. Again we took additional comfort in this approach.
- We have met with Bernard Madoff and various principals several times at Madoff's office, twice within the last year and have had numerous conversations in between.
- Fairfield Sentry reviews were conducted in 2002, 2004, 2006, 2007 and 2008.
- Several Senior Investment Professionals met with Madoff in 2004 and 2007; Structural Risk Analysis had a full review in 2006 and recently in 2008 with Madoff himself.
- We had insight into the portfolio through the M-Invest investment vehicle.
 - transparency into trades;
 - review of the statements for reasonableness;
- Citco and PwC in their administrator and auditor capacities for the investment vehicles visited Madoff's premises periodically.

18. Some of our peers were not invested – why did we pursue this investment idea?

- As a FoF, you also want to differentiate yourself with different holdings and this investment had been appealing.
- Through M-Invest, Citco as the administrator received individual trade tickets on which we were copied. This transparency gave us an additional element of comfort.



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19. Is there any chance you will recoup assets from this fraud?

- Given the limited amount of information available to us at the moment, it is not possible for us to predict the outcome of this situation.
- Our external legal counsels are currently evaluating this situation to determine our appropriate legal course of action.

20. What implications will this have for the hedge fund industry?

- This particular case was a situation where investors and the investment vehicles were victims of a massive fraud perpetrated by Madoff. Madoff was the manager of various hedge funds (Ascot, Fairfield, etc).
- This would be no different than investors losing an investment in, for example, Enron.
- The hedge fund industry has faced in 2008 a very challenging year, but no different from just about every other participant in the financial markets.
- This situation could put further media pressure on hedge funds. That being said, hedge funds should be seen as the victim, not perpetrator or cause of the fraud.

21. Are there any funds you are invested with that you are now concerned about after what has happened to Madoff?

- These events reinforce the need for manager diversification.
- Irrespective of Madoff, since the middle of 2007, we have increased our level of scepticism with the hedge fund managers on our approved list and are reassessing our convictions on a continuous basis, taking action whenever we deem it necessary.
- One has to emphasize the nature of this massive fraud, probably the largest and longest in history and which spanned over the longest period of time.

22. What is UBP's financial strength?

- Investors should rest assured that this affair has not affected the Bank. Our financial robustness and the stability of our balance sheet are of the highest order: not only do we have a Tier 1 ratio of 16% in terms of shareholder equity, which is twice the minimum legal requirement of 8%, but we have also had a constant balance-sheet structure over several years and no investments at risk. The Bank does not have any own-account investments in the Madoff group. Credit exposure to Madoff's investment vehicles in diversified client portfolios is immaterial.

UBP Alternative Investments

17 December 2008

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