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Along for the ride?

The Madoff affair As the official trustee tries to reunite investors with their cash, banks in America and Europe are accused of enabling the fraud, write Brooke Masters, Megan Murphy and Kara Scannell

When Bernard Madoff pleaded guilty last year to running the largest Ponzi scheme in history, he emphasised to the court that he had acted on his own.

Solemnly, the disgraced fund manager insisted that he had lied even to those closest to him and had deceived the world with misleading transfers, falsified trade records and fake account statements.

But Irving Picard, the bankruptcy trustee charged with recovering money for Mr Madoff's thousands of victims, has come to a rather different conclusion. In more than 20 lawsuits filed over the past three weeks, Mr Picard and his team of lawyers allege that at least 11 global banks and dozens of other financial institutions "enabled" Mr Madoff's fraud and profited from it.

Legal experts say the sheer size and complexity of the scandal mean the lawsuits will drag on for years. But they may end up redefining the legal duties that banks have to their customers, counterparties and the broader market. Just as the Enron and WorldCom scandals of 2002 refined the responsibilities of underwriting banks, the Madoff lawsuits could make new law on the duties of fund custodians and administrators.

The claims come, moreover, at a time when the entire industry is being forced to rethink its business plan and responsibility to customers in the wake of the financial crisis.

Although the details vary from lawsuit to lawsuit, Mr Picard alleges that banks including JPMorgan Chase, UBS and UniCredit had ample warning that Mr Madoff was a fraudster, so should be forced to cough up more than $40bn for their dealings with him. The claims cover everything from profits the banks made on Madoff-related swaps to fees they charged for serving as custodians and administrators for "feeder funds" that sent him billions of dollars.

He also wants some banks to cover billions of dollars in withdrawals that the feeder funds received from Mr Madoff – in order to share the losses more evenly among Mr Madoff's victims, as required by US bankruptcy law, and pay compensatory and punitive damages for allowing the scheme to continue unchecked.

Mr Picard has already convinced Santander, the Spanish banking group, and Union Bancaire Privée of Switzerland to pay more than $700m to the victims. Both banks had recommended Madoff funds to clients, although neither admitted wrongdoing in their settlements. More settlements are coming, he says.

But the other banks insist they have done nothing wrong and say they will vigorously defend the lawsuits. They say the withdrawn funds have been dispersed to investors.

"This is a case in which normal business relationships and practices are being distorted viciously in order to create and spread a fictional innuendo of suspicion, which is producing an international witch-hunt," says a lawyer for the successor to Bank Medici, a failed Austrian institution that is one of Mr Picard's targets.

Mr Picard's lawsuits differ from ordinary investor claims because he has special legal rights to claw back money taken from Mr Madoff's operation over the past six years. He has a particularly strong claim on the more than $2bn in withdrawals that funds related to the banks made in the last 90 days before Mr Madoff's December 2008 arrest.

"Because of the nature of the case and the extraordinary fraud perpetrated over 15 years [the trustee] is aggressively seeking recoveries... However many of the claims... are in grey areas and may take years to resolve. Some may make new law or clarify the law of fiduciary duties," says Harvey Miller, a bankruptcy specialist at Weil Gottshal, a New York-based law firm.

But Mr Picard goes further, alleging that some banks should be punished for not spotting the fraud while carrying out their ordinary duties as custodians and administrators, or for continuing to do business with him even though some people in their organisations had concerns. Several of the claims argue that Mr Madoff's scheme would have collapsed far sooner, saving some investors from losses, if the banks had severed ties.

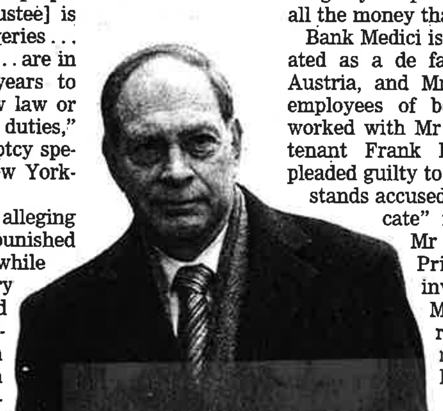
One door opens... Bernard Madoff arrives for a New York court hearing ahead of his conviction last year. Below, Irving Picard is pursuing where investors' money went EPA

"It almost seems like he is throwing mud everywhere and hoping some will stick," says Brad Simon, who defends banks and individuals in financial investigations. "Why should banks have a specific duty to undertake an investigation for every single account?"

Mr Picard's filings also include tantalising new revelations tying some blue-chip US and European banks to the biggest fraud in history. As bankruptcy trustee, Mr Picard has filed 1,110 subpoenas and used them to lay bare the web of relationships that – wittingly or unwittingly – helped to keep Mr Madoff's scheme alive.

Among the large banks, UniCredit is facing the biggest potential bill – Mr Picard named it in a $19.6bn claim that could in theory be tripled if he proves his allegation that the bank participated in an "illegal scheme". The Italian bank was, through its 2005 purchase of Bank Austria, owner of a 25 per cent stake in Bank Medici, a big sponsor and marketer of Madoff feeder funds to the cream of eastern European high society. The 60 people and institutions named in the claim allegedly helped recruit one-third of all the money that went to Mr Madoff.

Bank Medici is alleged to have operated as a de facto branch of Bank Austria, and Mr Picard claims that employees of both banks met and worked with Mr Madoff and his lieutenant Frank DiPascali, who also pleaded guilty to fraud. UniCredit also stands accused of seeking to "obfuscate" its relationship with Mr Madoff by having its Primeo hedge fund invest through other Madoff feeder funds rather than sending money directly to New York.



UniCredit says "we

An aggrieved 16,000

In December 2008, Bernard Madoff, a prominent New York broker and former Nasdaq chairman, confessed to running a multi-billion dollar Ponzi scheme – one that pays earlier investors from funds contributed by new ones it lures in. He is now serving a 150-year prison sentence for running one of the biggest frauds in history.

Mr Madoff's investors believed they were holding investments worth $65bn. Irving Picard, the trustee charged with winding up the business and recovering money for the victims, estimates their losses – cash put in minus cash withdrawn during the decades-long fraud – at $19.6bn.

Mr Picard has received more than 16,000 claims from people who believe they were victims. He has filed more than 80 lawsuits, seeking reimbursement and damages of more than $55bn. He has recovered more than $2.5bn to date.

will defend ourselves vigorously" and a lawyer for Bank Medici's successor says the withdrawals were paid out to fund shareholders rather than kept by the bank or its executives.

Like UniCredit, JPMorgan and UBS also face allegations that people in their management should have known about the fraud but continued to profit from it. The full claims against JPMorgan are not known because that complaint is under seal, but Mr Picard says he is seeking $1bn in fees and profits and another $5.4bn in damages as the bank "was at the very centre of that fraud, and thoroughly complicit in it".

JPMorgan was Madoff's primary US bank for years and reportedly helped structure investment products that allowed some European investors to gain access to the Madoff operation through feeder funds. The bank has previously confirmed that it withdrew $250m in the autumn of 2008 from a Madoff-related fund after a review of the bank's hedge fund exposures and once the bank became concerned about a lack of transparency. That payment may be within the 90-day clawback period.

The trustee also alleges JPMorgan "had clear, documented suspicions about the legitimacy" of the Madoff operation and that the bank "admitted in the months before Madoff's arrest" that the returns were "too good – especially in down markets – to be believable".

That appears to be a reference to a suspicious activity report filed by a London-based JPMorgan employee to the UK's Serious Organised Crime Agency in October 2008, two months before Mr Madoff's arrest. The report states the Madoff returns appeared "too good to be true" in light of the deteriorating market and notes a lack of transparency.

JPMorgan says the trustee's lawsuit "distorts both the facts and the law" and that it "did not know about or in any way assist in the fraud".

UBS of Switzerland is the target of two separate lawsuits seeking a total of $2.5bn. It served a variety of roles in connection with at least four European feeder funds, including as custodian, sponsor and portfolio administrator. But its wealth management arm explicitly refused to market Madoff funds to its own customers, the trustee lawsuits say. Mr Picard asserts that the bank "saw the indicia of fraud" but continued to work with Mr Madoff and allow him to both invest and hold the feeder fund assets.

Parts of the UBS complaints have been redacted by the court, but the public section alleges that UBS's wealth management unit refused to recommend the funds to its customers because Mr Madoff would not meet with its teams personally.

The bank drew up a specific side agreement for investors in its Luxalpha fund that explicitly delegated custody and administration of the funds to Mr Madoff and held the bank harmless. But some investors say they never saw the side agreement.

UBS says the funds were created for clients who specifically wanted to invest with Mr Madoff. It also says the trustee's allegations are "completely unfounded... UBS was not aware of any wrongdoing by Madoff".

'Many claims are in grey areas. Some may make new law or clarify fiduciary duties'

The $6.6bn claim against HSBC is focused more on alleged negligence. It claims that the UK bank failed to spot obvious signs of fraud while serving as custodian for a slew of European Madoff feeder funds. HSBC was hired to safeguard assets and keep account records but it delegated key parts of those responsibilities to Mr Madoff, allowing him to serve as sub-custodian and calculate the value of his fund, the complaint says.

Rules on custodial duties can be murky. "It really gets into what was the custodian's undertaking to the client. What did they sign up to do?" says James Cox, law professor at Duke University.

Mr Picard claims that HSBC failed to notice thousands of trades that allegedly occurred outside the reported daily price ranges and that Mr Madoff claimed to be parking cash in a money market fund that shut in 2005. HSBC says it will fight the allegations "vigorously".

The trustee is also seeking about $1bn from seven US and European banks, led by Citigroup and the French group Natixis, for allegedly helping institutional clients to ramp up their exposure to Mr Madoff by creating complex financial instruments whose returns were tied to the performance of various feeder funds.

In the years before Mr Madoff's spectacular fall from grace, international institutions lent billions of dollars to hedge funds and other investors around the world to help them gear up their investments with the swindler. But the trustee alleges some of them had ample warning Mr Madoff was a fraud, including Citi, where a managing director met whistle-blower Harry Markopoulos.

Mr Picard says Citi and Natixis, both of whom deny all the allegations against them, got their money out of those deals before the Madoff operation imploded, principally by selling the feeder fund shares they had used to hedge their exposure. But though even the banks have found it difficult to gauge their total writedowns, several contend they lost tens of millions – if not far more – structuring Madoff-related instruments for clients.

The big banks eventually forked out more than $13bn to settle investor lawsuits after the collapses of WorldCom and Enron. But it is by no means clear whether they will be similarly on the hook this time. Even Mr Picard knows that not everything will go his way. He told a judge this week that he expected a "significant recovery" of funds but appended the warning: "No one should anticipate that we will recover every single dollar we seek."