

December 2008 *MoneyMinute* Bonus– The Madoff Scandal

At ICM, we're fortunate to receive the latest thinking from many smart advisors across the country. The following is adapted from writings by Brian Fenn, CFP® of Carolina Capital Consulting, Dan Danford of Family Investment Center in St. Joseph, Mo., and Jeffrey A. Baskies, an estate planning attorney at Katz Baskies LLC, in Boca Raton, Fla.

By now you've probably heard about the \$50 billion Ponzi scheme perpetrated by Bernard Madoff, a New York City broker, former head of the NASDAQ stock exchange. Details are still sketchy, but it appears as if hundreds and maybe even thousands of so-called sophisticated individuals and institutions lost money over several decades.

It will be interesting to hear the details of this situation as they are uncovered in the days and weeks to come. We'll especially be interested to see where the SEC and other regulators were all this time.

His clients didn't see this coming. Could they have? Let's look at three key safety tips that would have prevented this from happening:

Never invest in anything you can't understand: Nobody knew *how* Madoff made money for his clients. As long as the dividend checks kept coming, his investors were satisfied. Madoff's fund was technically not a hedge fund, but it had the same black box secrecy similar to many hedge funds. That secrecy made it even more seductive to the "privileged few" who were "allowed" to invest.

If it sounds too good to be true, it probably is: Madoff built a reputation as a "miracle worker," never having a down year, regardless of the markets. Until the scheme collapsed, his clients got double-digit returns on their money, but believed they weren't taking any risk. With interest rates as low as they have been for years and years, there aren't any risk-free investments that can generate 10-15% returns. Anyone counting on interest from subprime mortgages has learned that lesson in a very painful way.

Know what you own: Stick to mutual funds, stocks, bonds and exchange-traded funds (ETFs) that are publicly traded and listed on major exchanges like the New York Stock Exchange and NASDAQ. They are valued independently, and you can check their reported returns against your own portfolio.

Use an independent custodian: Madoff held his client assets, managed them, and priced them, too. See the conflicts of interest? Investment performance can look better if the prices reported to clients are manipulated, which is allegedly how Madoff showed winning year after winning year despite market turmoil.

At our firm, our clients have an independent third party, Schwab Institutional, pricing each investment they own. We have no input on investment pricing, and that separation is a very good thing. Clients also get independent statements directly from Schwab. Clients have access to their funds at all time.

Check on insurance: Our clients benefit from fraud insurance. The first part is Securities Investor Protection Corporation (SIPC) coverage for \$500,000 per account. Then, at Schwab Institutional, there is additional brokerage insurance through underwriters at Lloyd's of London.

Final thoughts

At ICM we're saddened by the permanent losses suffered by people who put their trust in Bernard Madoff. Moreover, we're outraged by the lack of oversight by the SEC. Where were they when this was going on? The compliance requirements for Registered Investment Advisors are very thorough and very strict. Madoff was supposed to be keeping the same records that ICM keeps. Madoff's firm should have had the same regular, onsite inspections of every aspect of his client investments.

When the SEC did its routine on-site audit of ICM in late 2006, the list of documents they required from us was 18 pages, single-spaced. And that's just the *list*. The actual data added up to thousands of pages covering every aspect of our business.

While the SEC's compliance requirements take a substantial, ongoing portion of our time and energy, we believe in its value. We welcome our clients' questions about our policies and safeguards – and we don't want them to ever be embarrassed to ask. At ICM, there's nothing we value more than our clients' trust.

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