Your Investments - How Safe Are They?

Implications and Considerations after the Alleged Madoff Scheme

Since the news broke about the alleged fraud perpetrated by Bernard Madoff, it seems that every day another not-for-profit is disclosing its losses and some have even been forced to shut down.

Understandably, boards and executives of not-for-profits are nervous about protecting their investments and meeting their fiduciary responsibilities.

Here are some guidelines to consider now to help safeguard your investments:

First, it is time to **re-examine your investment policy**. Consider what percent of your portfolio may be invested in riskier investments, such as limited partnerships or private mutual funds.

Consider your use of brokers and money managers to hold and invest your funds, and how much can be placed with one broker. Are these percentages and limits appropriate for your organization?

Then, examine your current portfolio. Does its distribution comply with your policy? Is your money manager or broker aware of your limits and are they helping you comply with them?

Next, **consider where your investments actually are held**. Madoff was not operating hedge funds or private investment funds; his organization was a private money manager, where underlying
investments were held in brokerage accounts and owned directly by the investors.

How reputable are the brokers/money managers holding your investments? For less known individuals or organizations, have you checked their references or run background checks on them? Do they have reputable auditing firms? Does that auditing firm issue a SAS 70 report on the internal controls of the broker? If so, you should obtain the SAS 70 and read it thoroughly to determine whether the internal controls of the broker are operating effectively.

Keep in mind, though, that a SAS 70 only reports on the controls tested – you need to consider whether the report is comprehensive. If key controls are missing, this may be a red flag.

More importantly, does your money manager or broker hold your assets directly or is a third-party custodian entrusted with the assets? Clearly, your investments are safer when a reputable third-party acts as a custodian. If a custodian is involved, is a SAS 70 report available for the custodian?

On a monthly basis, you should **carefully review your brokerage statements**. Do returns appear reasonable based on current market conditions? Does transaction activity seem appropriate based on your investment policy and the market? Does the statement contain any suspicious transactions? Are publicly-traded securities properly priced as of the statement date?

Never hesitate to question information on your statement.

Alternative Investments
Many organizations have policies that allow use of alternative (non-publicly traded) investments, such as private investment funds or limited partnerships, as part of the overall strategy.

If your portfolio contains investments of this type, you need to consider the following monitoring procedures in addition to the guidelines above:

- Conduct periodic interviews of the fund manager. Make sure you are comfortable with changes in the investment strategy of the fund.

- Understand the composition of the underlying assets of the fund. If a fund manager will not share any information on the underlying investments, consider whether the investment may be too risky.

- Understand how the manager values the fund. Make sure the valuation methods are reasonable and consistent.

- Keep abreast of any changes in fund management. Make sure you're comfortable with any new managers at the fund.

- Review any communications, such a quarterly newsletters, issued by the manager and participate in group conference calls. Make sure those communications match what you see in your monthly statements.

- Compare returns to benchmarks for similar types of investments. Ask for explanations if returns do not follow the benchmarks.

- Know your legal rights. Many funds have limitations on how often you can withdraw or how much notice you need to provide before withdrawal. Make sure the liquidity of the fund matches your needs and seems reasonable in relation to the type of fund.

Organizations should not feel the need to liquidate their investment portfolios into "safe" investments in the post-Madoff era. What is needed is close monitoring of investments and implementing the common-sense guidelines above.

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