

DOW JONES NEWSWIRES

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By Michaela Cavallaro

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Many investors saw their portfolios shrink by 40% or more last year, and they're wondering whom to blame. They're skittish about the amount of trust they've put in their advisers - especially after the Madoff scandal.

If that's true for retail investors, it goes double for nonprofit investment committees and institutional investors.



Eric W. Bailey, CFA

“People are asking, am I down 50% because the market's down, or because I have a Madoff-type situation?” says Eric Bailey, managing principal at CapTrust Financial Advisors, an independent investment firm in Tampa, Fla. “Because of the market decline, many very educated people are not able to distinguish between those two scenarios.”

CapTrust's solution: fiduciary investment audits, in which the firm assesses both the individual investment manager and the chain of fiduciary responsibility for a given pool of assets. The firm launched the service in January, focusing largely on the institutional investors that make up most of its client base.

In its audits, CapTrust looks for a clear and unbiased chain of responsibility. “In an ideal scenario,” says Bailey, “an institutional custodian holds the assets, which are managed by an unrelated team of investment managers. Meanwhile, a third-party consultant helps select the managers and oversees the relationship with the custodian.”

“For large institutions,” Bailey says, “such an approach is *as basic as waking up in the morning and taking a breath*. Retail investors and smaller institutions haven't seen the need to separate those duties, however, and often use the same firm for all three functions.”

The lack of checks and balances is exactly what made the Madoff scandal possible. Bernard L. Madoff Investment Securities LLC performed all three roles for its clients.

CapTrust's audits have mostly proved reassuring. “In many circumstances, we're finding very high quality managers who just need to make a few tweaks,” Bailey says.

Other times, however, the firm's findings are anything but comforting. Bailey recalls one board that was shocked to learn its investment manager's Chartered Financial Analyst designation had been revoked, though he still listed the credential on his Web site and business cards. Bailey's team didn't uncover any evidence of fraud or mismanagement, but the board quickly decided to replace the manager.

“It was a clear breach of ethics,” Bailey says. “It doesn't mean the guy's a criminal and should be in jail - but neither does it mean that our client's money should be invested with him.”

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When conducting an investment audit, Bailey and his team start simply, searching the Internet for information about the individuals and firms employed by their client. They check the relevant regulatory bodies for any disciplinary actions or other problems. They look at transaction details, and they search for evidence of troubling patterns, such as high turnover among key managers.

“We've called people at home to ask why they left employment at XYZ Manager,” Bailey says. “We're trying to identify problems before they occur.”

Bailey doesn't expect interest in the audits to wane as the Madoff case recedes into the past.

“Over the last 15 years, interest in a more fiduciary approach has grown significantly,” says Bailey. “A year from now, if the Dow's back up and everyone's a little happier, the sense of urgency may be alleviated - but then we've got inflation to worry about. So there's always going to be a need for independent evaluation.”