Bloomberg BNA

Daily Report for Executives™

Investment Advisers

Investor Distrust After Madoff Cost Advisers $363B, Report Says

Clients of investment advisers in geographical areas where victims of Bernard Madoff's Ponzi scheme were concentrated collectively removed approximately $363 billion, according to a recent study.

The new study, published in the Review of Financial Studies July 14, shows how the largest financial fraud in U.S. history negatively impacted investor trust and affected investor behavior in areas where Madoff victims were concentrated, particularly the Northeast, parts of California, and southeast Florida.

The study marks the first time the effect of the Ponzi scheme on the financial industry has been quantified since the fraud was revealed in 2008, the authors said.

''Trust is really important in financial markets and financial intermediation, in particular,'' Noah Stoffman, an associate professor at Indiana University and one of the authors of the study, told Bloomberg BNA.

Scott Yonker, an assistant professor at Cornell University, also an author of the study, told Bloomberg BNA that approximately one-third of the money removed from investment advisers was deposited with banks, which generally are considered safer than the stock market.

''The most important thing about this study is how large an impact one fraud event can have on the entire financial system,'' Yonker said. ''It's not just defrauding the victims, but it has spillover effects in the economy, and so it affects other people's beliefs in the how the system works and causes them to lose trust.''

Other Findings The report also found that investment advisers in areas where Madoff victims were concentrated were over 40 percent more likely to go out of business than firms in a control group.

In addition, advisory firms that appeared to be similar to Madoff's purported advisory firm, Bernard L. Madoff Investment Securities, lost more of their clients' business than advisers that offered personalized financial planning.

The study further found that the loss of trust in investment advisers was strongest in areas with both Madoff victims and members of the targeted affinity group—older, wealthier Jews.

This study found no evidence that investors in areas where victims were concentrated had reinvested their funds in the stock market, as of 2012.

By Shira Stein

To contact the reporter on this story: Shira Stein in Washington at sstein@bna.com

To contact the editor responsible for this story: Phyllis Diamond at pdiamond@bna.com

To see the study, "Trust Busting: The Effect of Fraud on Investor Behavior," click here.

 ISSN 0148-8155