

How Does a Custodian Keep You Safe?

by the U.S. Fiduciary Services, Inc.
Individual & Institutional Investors Group

Despite the high ethical standards

of the majority of reputable investment firms¹, this last year exposed many grievous investment frauds to an increasingly uneasy public. Bernie Madoff was the year's most prominent sad story, having been accused of committing one of the largest financial frauds of all time. 2008 saw the conviction of Norman Hsu, who promoted an \$80 million hoax, and the investigation of Tom Petters in conjunction with the disappearance of more than \$3.5 billion of investor assets. Still under investigation are cases against Ar-

thur Nadel, the Sarasota, Florida-based money manager charged with losing \$350 million from his investors, Marcus Schrenkler, the Indiana-based hedge fund manager arrested in northern Florida regarding the whereabouts of more than \$50 million of investor money, and Robert Stanford, who is charged with defrauding investors of over \$8 billion by utilizing high yield certificates of deposit held in the Caribbean nations of Antigua and Barbuda. Could an independent custodian have been beneficial

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¹ Institutional money managers are governed by the U.S. Securities and Exchange Commission, and most of them also practice rigorous self-regulation based on codes of ethics that, for instance, can be found in Certified Financial Analyst Institute guidelines.

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to these and other investors who have been victimized?

A similar modus operandi tied together these recent frauds. Money managers paid out to old investors money from new investors by using phantom recordkeeping to falsify the performance data or to record nonexistent securities. It is nothing new to promise stellar returns to investors during short periods of time. Investor fraud has been, in fact, widespread since the late 19th Century. It has targeted investors of all kinds, in all walks of life. The ruses have ranged in degrees of elaborateness, but the large scale losses recently suffered by Madoff's investors included some normally very astute people.

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Because of these recent frauds, intelligent investors are lately wondering if a custodian can play a role in protecting their invested assets. In our minds there is no doubt that a custodian can dramatically reduce the risk of loss resulting from deceptive practices. Let us first start by thinking about the basics.

Fire, police and general employee pension funds are mandated, in some states, to use a custodian that is independent from the money manager or other plan entities. This is not the case in every state. At GreatBanc Trust Company, our professionals in the Illinois market do not have the same legal mandate to work under, because Illinois statutes do not require that public funds utilize an independent custodian. After reading about the details of the convictions and allegations mentioned above, we are sure you see the danger that can be presented by a potentially unscrupulous money manager having sole custody of their investors' assets. A trust company serving in the capacity of custodian is also a corporate fiduciary. In this role, the trust company adds a layer of checks and balances that contribute to the highest level of protection for the client. This results in a system where multiple parties discharge limited but interdependent duties ensuring the safety

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and soundness of the client. But is this enough to protect you from wrongdoing?

In fact, independence and separateness are not the only qualities in a custodian that should be sought out. The details of how the custodian performs their tasks are vital, as are accuracy, timeliness and its commitment to investing in technology. Safety and soundness are qualities that a custodial services provider arrives at intentionally, not accidentally. Proactive safeguards, back up systems and the financial well-being of the custodial company all factor as parts of an overall line of defense against fraud, errors or omissions.

Not everybody understands the daily tasks charged to a custodian, or the challenges presented by changing technologies and the ever-evolving complexities of the investment marketplace.

Custody seems easy until it is not. You need objective data on which to base your opinion of a custodian's suitability. While it's never possible to know everything about your financial service providers, we recommend asking your custodian some very specific questions. We have created a questionnaire that lists some of the most important questions to ask about the qualifications of a custodian. These questions are not easy to answer, and we think they provide a picture of the requirements for what needs to be in place between the time your investment manager makes a trade and the time when you receive your statement. Your custodian should be your key partner and chief advocate for the safety and soundness of your plan.

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How Does a Custodian Keep You Safe? *Conclusion*

Even though there is no absolute guarantee for protection from a financial fraud, the retention of a well-qualified custodian and the checks and balances they provide will go a long way in deterring wrongdoing.

Based on our decades of service to the institutional investor community, we are confident the care in choosing a well-qualified custodian will become one of the most important issues that you may face.

About Us

U. S. Fiduciary Services, Inc. is an employee-owned financial services holding company that owns all of the capital stock of Salem Trust Company, GreatBanc Trust Company, Pennant Management, Inc. and Waretech, Inc. While maintaining its special focus, each affiliate is also fully incorporated in the day-to-day business of the others. Our innovative approach to problem solving directly grows from the personalized and specialized teams whom we assemble and dedicate to each client.