

Guardian: One Who Watches Over and Protects

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The guardian of your plans' assets is your custodian.

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 also saw the conviction of Norman Hsu, who promoted an \$80 million hoax. Still under investigation are cases against Tom Petters, who allegedly absconded with over \$3.5 billion of investor assets, Arthur Nadel, the Sarasota, Florida based money manager charged with the disappearance of \$350 million invested with him, Marcus Schrenkler, the Indiana based hedge fund manager who was arrested in northern Florida regarding the whereabouts of over \$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 island nations of Antigua and Barbuda.

Absent in all of the above cases was an independent custodian.

A similar modus operandi tied together these recent activities. Some money managers paid out money from new investors to old investors, some falsified the returns or recorded nonexistent securities during these schemes. It is nothing new to promise stellar returns to investors. Investment schemes affect 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, many of whom reside here in Florida.

Because of recent media exposure of these frauds, many are now learning the role a custodian can play in protecting their invested assets from phantom recordkeeping. In my mind there is no doubt that a custodian can dramatically reduce the risk of loss resulting from deceptive practices. Let us start by reviewing the basics.

For our purposes a custodian is an organization defined as separate and independent from a money manager, and segregates the assets of one client from another on its records. Florida statutes recognize the importance of this basic principle and require fire, police and general employee pension funds to use an independent custodian. Not every state has the same mandate. After reading about the conviction and allegations above, I am sure the danger that could occur is perfectly clear to you. A trust company serving in the capacity of custodian also serves as a corporate fiduciary. In this role, the trust company adds another layer of checks and balances which contributes to the highest level of protection for the client. This results in a system where multiple parties discharge specific independent duties that are interdependent in ensuring the safety and soundness of the client.

Independence and separateness are not the only qualities of a custodian that should be sought out. Accuracy, timeliness, its commitment to investing in technology, safety and soundness are additional qualities you should look for in your custodian. These are qualities a custodian 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. You need objective data on which to base your opinion of a

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custodian's suitability. While it's never possible to know everything about your financial service providers, I recommend asking your custodian some very comprehensive questions. These questions are not easy to answer, and I 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. I will be speaking on the topic of a custodian's safety and soundness at the upcoming FPPTA School in Bonita Springs on October 4-7, 2009, but if you would like a copy of my custodial services questionnaire before then I will be happy to share it with you. You can reach me toll-free at 877-382-5268 or e-mail me at brad.rinsem@salemtrust.com.

In conclusion, even though there is no absolute guarantee of protection from a financial fraud, the retention of a well-qualified custodian, investment manager, consultant, actuary and legal counsel and the checks and balances these firms provide will go a long way in deterring wrongdoing. Based on my decades of service to the institutional investor community, I am confident the care in choosing and maintaining a well-qualified team will become one of the most important uses of your time.

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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