

Custodians heighten scrutiny of new and veteran advisers

Concerned about legal risk and PR black eyes, they want adviser-clients who are squeaky clean

By Dan Jamieson

January 2, 2011

Custodial firms have been raising the compliance bar for registered investment advisers, in some cases making it tougher for them to find a home.

Since the financial crisis and the massive Bernard Madoff fraud, custodians have become more concerned about the reputational and legal risks they could face from an adviser gone bad.

“They’re definitely getting tougher [about] whom they accept,” said Christopher Winn, managing principal at AdvisorAssist.

The larger custody firms have always been conservative in taking on advisers, but they’ve “absolutely” tightened up since the crisis, said Patrick J. Burns Jr., an attorney who works with breakaway brokers.

For a new RIA who has some regulatory issues, “we may have nowhere to recommend for [a custodial] affiliation,” he said.

The extra scrutiny also applies to advisers who are established at a custodian.

“If something came up on the ADV or on a background check, we would make the appropriate decision about” letting an adviser go, said Frank Maiorano, chief executive at Trust Company of America.


Likewise, RBC Correspondent Services and RBC Advisor Services have asked advisers to leave, said Craig Gordon, director of the clearing and custody units.

The units of Royal Bank of Canada do quarterly reviews of their adviser clients, he said, covering a range of business and regulatory issues.

Mr. Winn is working with an adviser at Schwab Advisor Services who was asked to leave over a state regulatory matter.

The adviser settled the case, “but Schwab said [to] find a new home,” Mr. Winn said.

InvestmentNews Reprints

 This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Reprints tool or the Reprints link at the top or bottom of any article, respectively.

- [View reprint options](#)
- [Order a reprint article now](#)

Firms have so many clean advisers in the pipeline, they don't feel the need to take a risk on someone with a black mark, Mr. Winn added.

Some aspects of the continuing review of advisers are “relatively new, maybe over the last year,” said Robb Baldwin, chief executive of Trade-PMR Inc., a custodian.

It's not just RIAs with smaller books being booted for transgressions.

“We've seen them as large as \$100 million” in assets, Mr. Baldwin said.

Most custodial firms are tight-lipped about the due diligence they do on their advisers, because they don't want to show their hand or give any impression to investors or plaintiff's attorneys that they're responsible for supervision or have approved an adviser's investment strategy.

Representatives of Fidelity Institutional Wealth Services and Pershing Advisor Solutions LLC declined to comment.

A representative of TD Ameritrade's custody unit did not respond by press time.

At Schwab, advisers are “contractually obligated to inform us of any material changes in their status,” spokeswoman Lindsay Tiles wrote in an e-mail.

The firm also monitors regulatory actions and “may surveil for certain types of activity in advisers' client accounts,” she said.

Either Schwab or an adviser can terminate the relationship with notice, Ms. Tiles said. “We review these types of situations on a case-by-case basis,” she wrote.

But observers said that the due diligence performed by custodial firms can be extensive and rival the investigation a major brokerage firm would perform on a new hire.

“It's an issue of managing the risk of the firm,” not a compliance issue, said Brian Hamburger, founder of MarketCounsel LLC, a consulting and law firm. “Custodians do not want to see their names in the paper.”

Custodians generally use an independent-review committee to vet new clients. They perform credit and background checks, in addition to reviewing ADV and U-4 forms for disclosure and business information.

Advisers who already have a custodial relationship can face similar reviews.

Firms also analyze business plans, and some firms may look into an adviser's clients as well.

If an adviser's client had failed to pay a margin loan or kited checks, for example, “we would be alerted to that,” said Mr. Maiorano, whose firm does background checks on the investors it takes in.


The vetting of new clients and the continuing due diligence counters somewhat the argument from broker-dealers that independent RIAs lack firm-level oversight.

Since custodians are service providers to advisers and have no official power to supervise them, their power is limited, observers said. While they can decide whether or not to provide custodial services, they can't discipline an adviser the way a brokerage firm can.

Still, observers believe that custodians should get some credit for keeping watch.


"I don't think [the critics] have taken a close look [at] the infrastructure involved in [bringing aboard an adviser] and in looking on an ongoing basis" at advisers, said Frank Pizzichillo, director of business development for MarketCounsel.

E-mail Dan Jamieson at djamieson@investmentnews.com.



Learn why we're ranked:
"Highest in Independent Advisor Satisfaction among Financial Investment Firms"

[Contact Us](#)



COMMONWEALTH *financial network*
commonwealth.com

Reproductions and distribution of the above news story are strictly prohibited. To order reprints and/or request permission to use the article in full or partial format please contact our Reprint Sales Manager at (732) 723-0569.