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COMPLIANCE WATCH: Investment Advisers Hunt For New Custodians

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By Suzanne Barlyn
A DOW JONES NEWSWIRES COLUMN

NEW YORK (Dow Jones)--Charles Schwab Corp.'s (SCHW) recent decision to stop accepting custody of alternative assets is prompting many advisers to form new - and unexpected - relationships with custodians who continue to engage in the business.

San Francisco-based Schwab, the largest custodian of assets among registered investment advisers, or RIAs, said through a notice on its advisor Web site that it will no longer accept custody of offshore funds, promissory notes or any investment securities that are new to Schwab and require issuer onboarding and set up.

Schwab's new policy is effective immediately.

Amy Webber, president of Cambridge Investment Research in Fairfield, Iowa, said her company has been fielding calls from many of its advisers who are affected by Schwab's decision. "It's still very new and we're trying to sort through what this means to whom," she says. About 200 of Cambridge's 1,400 advisers rely on Schwab as their custodian. Not all of those 200 advisers are in the alternative-investment market, she said.

The policy changes come as many advisers are considering alternative investments for clients in order to hedge against increasingly volatile market conditions.

Cambridge is concerned that other custodians may follow Schwab's lead, ultimately forcing some advisers to move funds more than once, said Webber. Cambridge has contacted several custodians to inquire about their future policies regarding alternative investments, she said. Fidelity Investments has been the only company to verify that it won't follow Schwab's lead, said Webber.

Fidelity "will continue to improve our alternative asset platform so that we can support advisers as their needs evolve," Charles Goldman, Fidelity's president of institutional platforms, told Dow Jones Newswires.

James D. Kaplan, president of KB Financial Partners, a registered investment adviser in Princeton, N.J., said Schwab's decision will cause little disruption. "It doesn't impact us in a big way. But it makes it more difficult to report," he said. The values of alternative investments will no longer appear on Schwab statements, he said. The values, however, are available from the institutions through which the investments originated, he noted. Schwab's alternative investment custodial service, he said, was "all about convenience."

A single custodian for all assets is also preferable from a compliance standpoint, said Webber. "It makes monitoring easier," she said. Cambridge is looking for custodians who will be able to handle their complete portfolios, she added.

Relying on two different custodians will likely drive up business costs, according to Michael B. Koffler, an attorney with the law firm Sutherland in New York who specializing in investment-adviser regulation. The Schwab decision has affected several of his clients, he says.

"You may see more of this, but certain custodians will now try to make names for themselves as being one-stop shops," he said.

Liability concerns may be a factor behind Schwab's decision.

The role of custodian for alternative investments is particularly challenging, according to Guy Talarico, chief executive of Alaric Compliance Services LLC in New York. These types of investments, by their nature, aren't traditional assets that are settled and cleared with Depository Trust Company, a national depository that records, maintains and transfers securities for its member firms, said Talarico. "There are valuation issues and questions about whether the asset is really there," he said.

Swaps, for example, are actually held by the prime broker who generates the contract, he said. The broker then typically provides the custodian with a statement that explains the broker's holdings and their value. "You're relying on the prime broker telling you, 'This is what the contract is worth'," he said. Mispricing could mean inaccurate net asset value of the entire portfolio, he added.

Charles Schwab spokeswoman Alison Wertheim declined to comment on whether valuation was a specific concern. She said, however, that Schwab was reviewing its custody of alternative-investment securities due to "recent events and anticipated regulatory changes in the financial markets." [BACK TO TOP](#)













"Alternative investments are complex, sometimes illiquid and less transparent than standard exchange-traded securities. Emerging reform efforts are likely to focus on the role of custodians and the need for more transparency in this segment of the market," she said.

The company is referring advisers to custodians such as Sterling Trust Co. in Waco, Texas, and Pensco Trust Co. in San Francisco, whose custodial systems are better suited to the alternative-investment market, said Wertheim.

Schwab's spokeswoman also confirmed that, effective April 30, it will no longer accept custody of most additional alternative-asset purchases. The company will add positions to existing securities as long as they aren't offshore or promissory notes, but won't add new alternative-investment issues.

(Suzanne Barlyn writes Compliance Watch, a column that focuses on compliance and regulatory issues affecting financial advisers. She can be reached at 201-938-4546 or by email at suzanne.barlyn@dowjones.com)

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