Q & A - The Safety of your Money at TCO

Editor's note: given the Bernard Madoff scandal as well as continued market disruptions, Steve Turnbo of Schnake Turnbo Frank PR recently visited with Bob McCormick of The Trust Company of Oklahoma (TCO). Following is their conversation:

Steve Turnbo: The Madoff scandal, brokerage firm bailouts and bank failures have made many investors worry about the safety of their investments. How does The Trust Company protect its clients' assets?

Bob McCormick: First, it is important to understand that all client assets are always owned by them. TCO never has legal title to the assets even though we hold client assets at the Federal Reserve Bank for government securities and Depository Trust Company, or DTC, for non-government securities. DTC is the depository where all financial institutions and almost all investors hold their stocks and bonds. Legal title always stays with our clients unlike deposits at a bank. Our creditors, if we had any, cannot lay claim to them. Simply put, no third party can lay claim to client assets to satisfy a claim against TCO.

Secondly, as a state-chartered trust company, we are closely regulated by the Oklahoma State Banking Commissioner. They thoroughly examine us every year. In addition, since we either currently act or have acted as the trust department for several banks in Oklahoma, we are or have been examined by the FDIC, Comptroller of the Currency and Federal Reserve.

Lastly, our outside audit firm, Stanfield and O'Dell, performs a financial audit annually, which it submits to our board of directors. In addition, our internal audit function is performed by the CPA firm of Sewell and Taylor. They audit all aspects of our operations throughout the year, including 100% verification of all client assets. They too report to our board, which by the way is an independent board. The majority of the board members are local businessmen and community leaders.

Steve: That's a lot of people looking over you. But what about the safety of client assets if someone at TCO made a mistake or did something worse?

Bob: In addition to the controls listed above, we carry two types of insurance: errors and omissions insurance for losses due to mistakes and a fidelity bond for losses due to fraud. These insurance policies provide a backstop for large losses we do not cover ourselves. We also require a thorough financial and criminal background check for all newly-hired employees.

But your question really gets to the topic of how we control the flow of money and securities at TCO to make sure everything is handled appropriately. The essence of our structure is that we operate under a team approach whereby the various parts of the team have responsibility and authority over only certain aspects of the flow of money and securities as well as issuing client statements. This separation of duties insures different sets of eyes are looking at all investment and movement of monies.

For instance, investment managers can execute trades but cannot move money into or out of accounts. Likewise, the Administrative group can transfer money in and out of accounts but cannot buy or sell securities. The Operations group moves securities and reconciles all money and security positions every day to insure every share of stock and every dollar are properly accounted for. The Operations group and Administrative group together process and mail client statements. We also have new statements coming out that are sent by our third party accounting provider. There are also various oversight and approval steps required for these activities. These divisions of duties are examples of the control features we employ in the safekeeping of our clients' assets.

Steve, you mentioned the Madoff scandal earlier. It is important to keep in mind that by Bernard Madoff's own admission, he ran a $50 billion Ponzi scheme through a minimally-regulated investment firm that appears to have had little or no internal controls or audit oversight. Moreover, clients were not allowed to ask too many questions. There were no checks and balances and certainly no transparency.

Steve: A lot of investment firms and bank have run into financial problems. Can you talk about the financial strength of TCO?

Bob: Sure. First, keep in mind we are a privately-held company so we do not make our financial statements public. But we are financially strong and solidly profitable, having posted profits consistantly for over 20 years. We have no debt and our shareholder base is very stable and loyal. We have approximately 70 shareholders, primarily located in Oklahoma, none with greater than a 5% ownership interest. The year 2008 closed with many financial firms posting historic losses, requiring bailouts and even going under. We closed 2008 profitable and able to financially continue to deliver top-quality services to our clients.

Steve: That is very good to know. But honestly, just a little pain might be reassuring. After all, it has been a tough year for almost all investors.

Bob: That's a valid point. We have certainly been impacted by the market turmoil. Our fees are largely based upon the market value of the assets we manage so the drop in the stock market has reduced our fees. Much of our real estate and oil and gas fee income is also based upon market values as well. Our interests are aligned with our clients' in this way – and appropriately so. In times like these we probably work harder for certainly less money. But we firmly believe our compensation should be tied to our clients' success – for better or worse.

Regardless of the direction of the markets, we remain committed to delivering the high level of service our clients have come to expect and deserve. In recent months we have taken a much more proactive stance communicating with our clients and answering questions they have about the market turmoil and their investments.

Steve: Let me turn to the topic of investing. What are you doing to help protect client assets during this period of fear and uncertainty?

Bob: The term "fear and uncertainty" is certainly appropriate for the financial turmoil investors experienced in 2008. The market has experienced fear and uncertainty before, although arguably 2008 experienced the highest level of fear in decades. However, key to what we are doing to help protect client assets is to stay focused on sensible long-term goals and objectives. Just reacting to the fear and cashing out is almost never the right move to make. Focusing on the long-term goals remains the first priority. The investment goals need to be supported by sound strategies that have withstood the test of time as well. To that end, we do not invest in high-risk, illiquid investments or leverage our investments with the use of debt. It is not that doing so is always bad, but doing so in bad times can create irrecoverable losses.

Right now we are adjusting our strategies to address the unprecedented market disruptions. As painful as the losses in the equity markets have been, the disruptions within the bond market have in many ways been even more extreme. As a result, we have stepped up our quality requirements measurably. We have temporarily suspended the purchase of individual corporate bonds and have sought alternatives where we were using corporate bonds. These alternatives include government agency bonds, high-quality bond funds which improve liquidity and diversification, and brokered CD's. In the tax-exempt market, we are focusing more on new issue bonds where the ratings from the rating agencies are more current as well as requiring higher ratings in general as an extra measure of safety. While few municipalities have gotten into trouble so far, the economic downturn could cause future funding challenges for many states and municipalities.

Within our equity portfolios, we continue to underweight the financial sector. We realize this will not always be the right action, but for the last two years, it certainly has been. We also have increased our level of diversification within our equity portfolios. Admittedly, this increased diversification has not prevented losses as the market meltdown has been global – big, small, domestic and foreign. All segments of the market have been hit hard. But greater diversification does help reduce the chance of massive losses in a portfolio due to an individual company blowup.

Steve: Thanks. Let's wrap up by coming back to The Trust Company itself. Can you tell me a little more about the company and its philosophy on working with clients?

Bob: The Trust Company opened its doors for business in 1981 and was formed on the basis of sound asset management and superior client service. From its beginnings, TCO has viewed its fiduciary role to its clients as paramount. We are an independent trust company focused on asset management and trust and retirement services. Independence means we are not beholden to anyone but our clients. We do not make loans, take in deposits, sell securities or life insurance. Nor do we earn any commissions or third-party fees for investing our clients' monies. Our investment decisions are based upon what we believe to be in the best interests of our clients.

In addition, we do not prepare tax returns or draft trust documents. Our philosophy is that we will work with the tax and legal advisors a client may have. We do not compete with these other advisors but view the relationship as a team approach to insure our clients' interests are achieved.

We are fortunate to have a stable group of dedicated employees that want to be at TCO. Most have worked for other financial firms and all have chosen to be at TCO. Many in our senior management have run trust departments or divisions at other larger firms. And lastly, we are blessed to have the clients we do. We recognize we work in a very competitive profession so the loyalty and confidence our clients have placed in us is humbling and greatly appreciated.

Steve: Thank you Bob. Here's hoping 2009 will be a happy and prosperous new year!

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