It’s Better To Be Safe Than Sorry!

As Ponzi-like scandals (Bernie Madoff, etc.) periodically make national headlines, investor concern with the safety and security of their money understandably rises. Yet, the world of investment firms is multi-faceted, and the rules that apply to different types of firms vary as widely as the players in this field. As we discuss our services with prospective clients, a question that often surfaces concerns the processes we have in place to protect clients from a Madoff-type situation.

Earlier in my career, existing or potential clients would never ask specific questions about how operations or compliance functions work as related to the safety of their investments. But, in today’s climate, this is a question that is asked often. With this in mind, let us turn to some helpful questions to ask your advisor and some warning signs that you should be aware of.

The first set of questions you should ask your advisor is how his or her firm is audited and regulated. There are non-regulated and regulated advisors. As a state-chartered trust company, Trust Company of Oklahoma is regulated primarily by the Oklahoma State Banking Commission. In addition, since we serve as the trust department for several Oklahoma banks, we are or have been regulated by the FDIC, Federal Reserve, and Comptroller of the Currency. This regulation includes annual in-depth on-site exams.

Other types of advisors may be regulated by the Financial Industry Regulatory Authority (FINRA). FINRA is a not-for-profit corporation that acts as a self-regulatory organization, promulgating rules that govern brokers and dealers and certain other kinds of professionals in the securities industry. FINRA itself is regulated by the SEC.

After determining if your advisor is regulated or non-regulated, you should ask: What are the checks and balances in my advisor’s systems that keep widespread fraud from occurring? Are the firm’s auditors independent? Your advisor should be able to answer these questions.

“Fraud and falsehood only dread examination.
Truth invites it.” – Samuel Johnson

The second set of questions you should ask involves the custody and effective control of your assets and what happens in case of fraud or other misconduct. At TCO, all assets are either held at the Federal Reserve (government securities) or Depository Trust Company (DTC) for all other securities. In addition, ownership of your assets is always retained by you, the client.

Be sure to ask if your advisor is the custodian. A custodian is a financial institution that holds customers’ securities and other assets, in physical or electronic form, for safekeeping against theft or loss. Also, does your advisor’s firm have control over the custody of your assets? If the answer is no to either of these questions, who is the custodian and are the assets held in your name or the name of the firm?
Advisors who are not regulated should not have anything to do with the custody of the assets, including ownership interest in the custodian they are using. Additionally, you should ask to what extent the firm insures clients against loss due to employee misconduct. Lastly, pricing investments should be performed by an entity independent of the advisor so as to remove the ability to manipulate the market value of your investments.

Even among regulated advisors, it is prudent to check out who you are dealing with as an individual. Get to know your advisor and make sure the relationship is a good fit. Finally, remember there are no investment vehicles that provide high rates of return with little or no downside volatility. The investment plan and strategies offered should make sense to you. If not, ask questions until you are comfortable. You might think asking these questions is a given, but over my 25 years in this business, I have seen greed cause people to have historical and common sense amnesia.

When I sit down to discuss how we do business at TCO, I can look confidently in the eyes of my clients and prospective clients with the knowledge that our firm will only do what is best for the client. That is the essence of the fiduciary standard of investing.

It is all about alignment and trust. How you are aligned and connected with the people who manage your investments is critically important. Our company would not have the word “Trust” as a part of our name for over 30 years if we did not know how to earn it.

David T. Stanley
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