

In The Land Of Giants

Does a small custodian have a chance these days? If it offers something advisors can't get from the Big Three, it does.

> By David J. Drucker

The history of custodying assets for independent RIAs is a striking example of how a major force grabbed (and grabbed and grabbed) an increasingly larger share of a market no one else seemed to notice for years, eventually becoming the nation's largest RIA custodian.

In fact, it was sometime in the mid-'80s that a Schwab representative came to the offices of Malgoire Drucker Inc. in Washington, D.C., to talk to my partner and me about the utility we might find in the department they were thinking about creating for fee-only investment managers and planners like us. "We noticed you've been opening accounts at Schwab for many of your clients," said Lynda Sarinske from Schwab. We replied that Schwab was the one place we'd found where we could invest in a host of different mutual funds for clients and see the results all in one account and on one statement, thus confirming what Sarinske hoped to hear: that Schwab already had the beginnings of the infrastructure they would need to formalize a support service for advisors.

We all know what happened from there. Schwab's institutional program took off, and took off some more before rivals Fidelity, TD Ameritrade and, more recently, Pershing Advisor Solutions, took notice. In round numbers, Schwab boasts a market share today about three times that of Fidelity and about eight times that of TD Ameritrade, with about \$500 billion in advisor assets—give or take. According to Schwab's annual report, their institutional business now boasts operating margins of nearly 40%.

And it got to where it is by being good. In spite of perennial perceptions by Schwab's 5,000 or so advisors that the giant is stepping on their corporate toes with retail programs designed to siphon away clients, they show remarkable loyalty to its trading platform and related support services. Mavericks occasionally flee to the arms of Fidelity, TD, Pershing or LPL Financial Services—unless they've done their due diligence and aren't afraid to move to a whole different level of custodian exemplified by Shareholders Service Group and Trust Company of America.

Many advisors have never heard of SSG or TCA, and those who have aren't likely to know what these firms offer. But if

you want the best for your clients, maybe you need to look at these custodians. Just as small advisors can respond more quickly than large institutions to market changes and perceived opportunities, so can smaller custodians.

Shareholders Service Group

Shareholders Service Group (www.shareholdersgroup.com) of San Diego began when Peter Mangan, of Jack White & Co. and TD Waterhouse fame, got together with Jack White's Mark Reed and decided what the advisor industry needed was a service platform that didn't rest on a retail operation (the reason for most of Schwab's run-ins with its advisors). Barry Boyte, with a history at insurance broker-dealer W.F. Griffith and—earlier—Jack White, joined Mangan and Reed in launching SSG in September 2002.

"Having no retail connection is more important than many advisors realize," says Mangan. "A custodian's internal management structure must reflect the company's business and, if it has a retail business, then there will be conflicts with the advisor business."

SSG's other claim to fame is service. "We believe we can provide a level of service advisors simply won't find elsewhere," adds Mangan. However, some advisors read more into this statement than is immediately obvious: "SSG is for smaller advisors," they claim. "Let's just say we offer a full scope of RIA custodial services while not imposing minimums on advisors," Mangan replies, "which earns us tremendous loyalty from advisors building new businesses."

SSG works with many advisors managing over \$50 million, and some with over \$100 million; yet, today's assets under management don't always tell the whole story. While still with Jack White, Mangan and his team took on a new advisor by the name of Charles Brandes, who has since ascended to No. 382 on Forbes' 2006 List of The World's Richest People. "Brandes started out with a handful of accounts and now he manages over \$100 billion, so we cut our teeth with good advisors who knew what they wanted," Mangan says.

How big is SSG? Figure eight to ten employees (all of whom are SSG owners) and \$1.3 billion in custody. "We've had a moderate increase in growth year after year," says

Boyte. “Nice steady growth.” Adds Mangan, “The pace of growth and the quality of growth has been manageable, and has allowed us to develop a good reputation.”

If Boyte and Mangan’s attitude about growth seems a bit casual, it’s because they’ve structured SSG to be profitable at just about any level of business. “We do have goals,” says Mangan. “We figured we’d pick up a certain number of advisors with a certain amount of assets each month, but those goals aren’t as important to us as making sure we have the right number of people to service the account volume we have. Whether we’re custodialing \$1 billion or \$100 billion, we focus on how many advisors we have and how many trades they’re doing so we have the right staff; that way, we ensure good service, but we also know each account will be profitable.”

The advisor loyalty Mangan referred to earlier is evident when talking to SSG’s advisors. Says Don Martin of Mayflower

Thornton, Thornton Wealth Management LLC, Atlanta.)

- “I don’t remember ever being put on hold by SSG. I also have the sense I’ve talked to every single member of the company at some point. Everyone is accessible and helpful.” (Linda Stratton, Stratton Advisors, Oro Valley, Ariz.)

- “I know all of their team by voice when I call. They resolve problems quickly and efficiently and they have shown a real willingness to help me out. I consider them a primary reason why my business has taken off over the past three years.” (Jeffrey Bogue, Bogue Asset Management LLC, Wells, Maine.)

- “There’s always a real person answering the phone who has the ability to respond to most of my questions.” (Lauren Klein, Klein Financial Advisors Inc., Newport Beach, Calif.)

Let’s say you decide to transition some or all of your client accounts from one of the Big Three over to SSG; what kind of assistance can you expect? “We provide a full transitioning program,” says Mangan, “so the advisor doesn’t have to fill out a lot of forms. Once under way, the advisor can see her transfers in process online, can see the new accounts open up and can track all progress from one custodian to the other.”

Once you are fully transitioned, what will you find? “Trading platforms are fairly similar across custodians,” says Mangan, “but we have some additional tools. Advisors can create model portfolios and rebalance across multiple accounts, and we can now rebalance for the advisor, if desired.” The way this works, says Mangan, is the advisor controls the intellectual content of what’s contained in his models as well as the client relationship, but once those things are set, SSG periodi-

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Capital in Los Altos, Calif., “I use SSG as my sole custodian. Because they are small and employee-owned, they empathize with me as a small business owner. I feel in control of the relationship, respected, and I get excellent attention.”

But those are just the touchy-feely benefits. “I like that they can custody defined benefit plans, which Ameritrade told me last year they could not do. SSG’s free software helped me analyze old stock certificates of companies that were merged out of existence, something not available at Schwab,” Martin continues. “And since SSG clears through Pershing, they are backed by the world’s largest B-D.”

Virtually every advisor I spoke with praised SSG’s service with comments like:

- “Peter Mangan personally spent an hour and a half with me explaining SSG’s strong desire to work with new advisors and how they would support me. He was right; the staff has been tremendously helpful to me. SSG is one of the few custodians that encourage new and small advisors.” (Everette Orr, Orr Financial Planning LLC, McLean, Va.)

- “I moved all my clients to SSG away from TD Waterhouse and Schwab in June of 2004. Mangan and his team are very responsive. I was sick of bad service from TD Waterhouse and being a peon with Schwab. The agility and responsiveness of a small custodian is a plus, especially when they are owners of the firm.” (Carl F. von dem Bussche, Financial Guidance Group Inc., Palm Harbor, Fla.)

- “Peter Mangan and the rest of the team at SSG are true professionals and really place a premium on first-class service. They make it easy to do business with them.” (Russ



cally rebalances according to his instructions. “We can also calculate fees and, with the advisor’s approval, collect and forward them to the advisor,” adds Mangan.

Another thing SSG can do, in approved states, is hold and report on variable annuity contracts. “The advisor is able to keep an annuity in view, on his client’s statement with the client’s other investments and, in some cases, can see the subaccounts and handle the rebalancing for those accounts online.” SSG is licensed for this purpose in eight states, and is adding to that list as business requires.

If you want to get away from the Big Three but SSG’s framework still isn’t what you’re looking for, maybe Trust Company of America’s services will work for you.

Trust Company Of America

At Trust Company of America (www.trustamerica.com) in Centennial, Colo., D. Terry Reitan, president and CEO, explains that TCA has been a custodian for 35 years, entering the advisor business about 10 years ago. But it wasn’t until 2003-04 that TCA came out with its latest software. “That’s our claim to fame,” says Reitan. “Our software is radically different than what anyone else in the market has.”

With something over \$5.25 billion in advisor assets, TCA wants advisors to understand the differences between a custodian and a trust company platform. (Just to be perfectly clear, TCA isn’t actually a trust company. It is a specialized provider of custody and back-office services to the financial services industry seeking to deliver scalability that will allow advisors to spend less money on overhead and more time growing their business). “With Schwab and other custodians, they run your business from what is basically a brokerage platform built on the concept that every client has an account holding many different securities; some clients are risk takers, some aren’t, but every account is individualized.”

What TCA did differently was to realize that most successful advisors use portfolio modeling. “So our platform is model-centric,” says Reitan. “That’s given us tremendous flexibility. If we can offer superior technology to the marketplace, we think we can take business away from the big guys.”

So how does the modeling work? “With our software, an advisor can employ multiple models within a single account,” says Reitan. “With other custodians, modeled portfolios are treated as separate accounts and must be rebalanced and managed by the advisor as such. We’re trying to make life easier for advisors who use models, which is becoming a

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—Terry Reitan

characteristic of the largest advisors.”

An advisor using a typical portfolio management system like Advent and a typical custodian like Schwab would run their models in Advent and upload trades to Schwab, says Reitan. “Our models are right there on our Web site. The advisor can revise his models and rebalance his accounts in seconds.”

Reitan says TCA has been working on a model-within-a-model capability. “Say an advisor wants to allocate 15% to international ... well, he can have a model underneath that allocation model that says, ‘I want that allocation to be made up of two mutual funds, three ETFs and a few individual securities.’ He can adjust his allocations at both the top level and the lower level.” TCA issued a press release in September 2007 to announce this “model-within-a-model” capability, which it calls “Composite Models.”

The other characteristic of larger advisors besides modeling, says Reitan, is the use of TAMPs, or turnkey asset management programs. “We have a multimanager unified account program that’s attracting a lot of interest. If an advisor wants to use, say, three managers, those three firms can trade [using their own] models as they normally do and their models will show up in the advisor’s portfolios.” TCA unveiled this program, which it calls its “Multi-Manager Unified Account Program,” in September 2007.

Mentioned as almost an afterthought by Reitan and Sara Nelson, vice president of marketing, is TCA’s online portfolio reporting capability that complements its other platform features. Says Nelson, “Our advisors get real-time position data allowing them to do detailed what-if analysis right on our platform in order to make critical trading decisions. In fact, some advisors find they don’t even need to maintain their own portfolio management system.” TCA’s online reporting gives advisors both performance numbers and tax-lot accounting, adds Nelson.



If TCA sounds extraordinarily tech-oriented, that's not by accident. "The single biggest effort we make in this organization," says Reitan "is software enhancement. We're really more of a technology company that happens to be in the custodial business."

TCA proves this time and again with services such as its recently released Sales Analytics management application. Integrated right into its custody platform, this application allows advisors to compile numbers and statistics across their client bases, a potential time saver in the running of calculations to support critical business decisions.

Bob Vance of Vance Capital Management in Sonora, Calif., custodies client assets with Schwab and TD Ameritrade—and lately, TCA. "We probably have 20% of our accounts at TCA now and most of our new accounts end up there," he says. With about 1,000 accounts, Vance says he's tried to set up models at Schwab, but the only investment option in Schwab's modeling is mutual funds. "The bugaboo is that funds close down or minimums become too high and we have to go in and adjust our models. This is frustrating. With TCA, we can set up models any way we want with any combination of things."

Vance says he could have one client with accounts allocated according to three different models. "Part of the account might be in a core-and-satellite model, another part in a sector model using rotating ETFs and a third part in a hedge-type model with defensive investments. With Schwab, it took me five months to change all my clients' models when we decided to go more defensive. With TCA, I can make changes and trade all my clients in a half an hour."

One thing to keep in mind is that, TCA sends out quarterly client statements structured much like those one would receive from an actual trust company, which Vance likes. "My clients are less likely to get focused on month-to-month performance. Also, paper confirms don't get sent out with each trade; they're summarized on the quarterly statements."

As for fees, Vance likes paying 25 basis points (with a \$100 minimum) per account for management access and private labeling. It may not make sense for smaller accounts, which he maintains at Schwab, but it works for most of his clients.

David Connelly Jr. is a principal with Symmetry Partners LLC in Glastonbury, Conn., a company that's been doing business with TCA since 2001. "We're RIAs with a different kind of business. We started working with outside advisors who outsource trading to us and realized TCA had just what we needed. First, they could brand us; second, they have the

online performance reporting we needed; and third, we can open accounts and get the account numbers on the fly, as well as check transfers whenever we want." Connelly says Symmetry opens 400 to 500 accounts with TCA monthly.

Like Vance, Connelly is awed by TCA's back-office capability and credits it with making the management of Symmetry's 13,000 accounts (representing \$2 billion) easy, fast and accurate. And while not as small as SSG, TCA is still very small compared to the Big Three. "Because they're smaller, you can get an audience with them. Schwab and the others are the cream of the crop from a customer service standpoint, but where TCA wins the day is in its willingness to make the [technology] changes we request. Even when we were at half a billion, we couldn't get Schwab's attention."

And if you get to the point where you're comparing these two, don't assume they will be as similar in their pricing as are the Big Three. "Their pricing will be very different from ours," says Mangan of TCA. "They charge an asset-based fee rather than charging by transaction. We've got the ability to do that if the advisor wants; we can provide asset-based service that includes all costs of trading, and we don't cap the number of trades the advisor can do for the client."

"When we get advisors calling us to compare us with TCA, we have to be specific about how transaction fees are charged so they can compare apples to apples," adds Boyte. "We believe that, unless they compare actual costs and deduct the interest they would have received on money balances [from the TCA side of the comparison], they're usually better off paying transaction charges."

Of course, transferring client assets is a huge pain, and many advisors will prefer to remain with a nationally recognized brand name. But if a smaller custodian comes along that can successfully execute a platform of services advisors can't get from Schwab, Fidelity or TD Ameritrade, it's going to find a place with advisors. Shareholders Service Group and Trust Company of America certainly do that. So if you're a new advisor looking for a custodial home, or a veteran advisor dissatisfied with Big Three service, don't assume only a large institution will be able to meet your needs. ☺

An independent financial advisor since 1981, David J. Drucker, MBA, CFP, has been an industry influential for many years. Learn about his books, public appearances, Practice Lifecycle practice management portal, Virtual Office News and the annual Technology Tools for Today conference at www.DavidDrucker.com.



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