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THE GLUCK REPORT

By Andrew Gluck

Watch This One

Trust Company of America is challenging the big custodians

THERE'S A NEW COMPETITOR TO Schwab, Fidelity, and Waterhouse's RIA custodial business. It's Trust Company of America. If the name sounds familiar, you're probably confused. Contrary to the prominence its name implies, TCA is not some white-shoe institution catering to old money. It's a startup with about $3 billion in advisor assets. But the man behind the company, Stephen Finn, is one of those rare entrepreneurs with a knack for the kind of marketing flair evident in the company's name. He's built several successful financial services businesses over the last 25 years and TCA could become his biggest success yet. But it won't be easy.

TCA is going after a very specific segment of the RIA business: advisors with more than $25 million under management who manage money in mutual funds or ETFs and use model portfolios to run their investment advice business. TCA wants advisors using models because they see that as being a scalable business where trading costs can be minimized through the use of technology.

TCA has just unveiled a technology platform that rivals Schwab, Fidelity, and Waterhouse—in fact, it may be better in certain respects—and its technology platform is targeted toward serving the needs of its niche in the RIA market—those who use model portfolios to trade in bulk.

What's impressive is that TCA says it is only interested in RIAs that will pay it at least $100,000 a year in fees, because then it can afford to provide the client with totally personal service and technology. That's a gutsy business idea, but one I believe can work in the RIA market. Custody is a commodity. Custodians must differentiate themselves with technology and service, and that's what Finn is aiming to do.

What's Different?

I asked TCA for specifics about how its service is better. The answer came in a long list that was neither substantive nor compelling. I told that to TCA's VP for marketing, Sara Nelson. Her reply: "We know we're providing superior customer service because our customers tell us that, and that is the nature of customer service. Everyone says they have it, but we really do."

Nelson's right. It's hard to prove that you offer better customer service than your competition. Good service providers in the RIA industry become known by word of mouth. Still, some specifics on TCA's list of service extras indicate where TCA may indeed be able to provide RIAs superior service.

For instance, when an RIA moves assets to TCA, TCA assigns a conversion manager to the RIA. For six to nine months, the RIA works exclusively with that manager to transfer assets. TCA says this is different from other large institutions where an RIA might get shuffled around to different service reps.

Once the transfers are complete, TCA assigns a dedicated trading rep to help with transactions and a dedicated service rep to the RIA's account. They are trained by the conversion manager to ensure an RIA's business is understood by the service reps.

Making service reps own a client's problems is a good idea. Of course, it must be well executed. It won't be much good to have a dedicated service rep if your rep must also work with 20 other RIAs. Nelson assures me that this is not happening.

No Call Centers

Another indication of the commitment to personal service: TCA gives you a direct line to your service rep and does not have a call center. TCA also says it will customize account statements with an RIA's logo and brand a client account look-up Web page. TCA also assesses, collects, and deducts all your fees each quarter—even if you have multiple pricing schedules—and there is no need for you to upload a spreadsheet as some other custodians require.

Will these differentiators be enough? Maybe. Finn, 54, proved himself capable of converting profits out of one of the most troubled corners of the financial services industry. He got started in the industry by working with limited partnerships. He graduated from University of Santa Clara in 1976 with an MBA after getting a BA in business and showing a special interest in computer science and systems analysis. He landed a job in Silicon Valley selling payroll service platforms to small businesses for a couple of years. In 1981, he went to work at LCS Investor Services selling data processing to small businesses, including limited partnership syndicators. He became a specialist in systems for syndicators of direct investments and turned LCS into a securities transfer technology platform for syndicators and wirehouses.

TCA is looking to have fewer relationships but put more effort into helping each of them

His timing was great. Finn got into the business of processing direct investments right when the LPs were about to take off. He bought out one of the partners at LCS in 1985, and the remaining two in 1988. That same year, LCS bought Gemisys, another securities transfer agent. Gemisys could process everything for syndicators, from subscription agreements to blue sky filings, commissions, and K-1s. “We rode the wave to the peak in 1988,” says Finn.

By 1990, however, the LP business was getting ugly. “I decided to reinvent the company and find a new business,” he says. “I was too young to retire.”

It took three years for the LP business to become a disaster, and Finn saw it coming. Integrated Resources, Consolidated Capital, and the wirehouses—his biggest clients—would be ruined or forever tarnished by the LP scandals.

“I was peddling as fast as I could to figure out a new business while Gemisys was still doing well,” says Finn. “But I could see that eventually all the LPs would be liquidated and we wouldn’t have a business.” As the bottom was falling out and he saw the LP transfer agent business evaporating, Finn demonstrated the resourcefulness that it takes to succeed in the RIA custodial business: He discovered not one but two, businesses that would capitalize on the LP disaster that was shrinking Gemisys.

Terry Reitan

The LP Secondary Market

In 1993, Finn helped create a secondary market for LPs. He bought out three mom-and-pop businesses that were brokering LPs and consolidated them into one business that he called American Partnership Board. APB matched buyers and sellers and created liquidity and made the secondary market for LPs fairer. Until APB came along, the illiquid secondary market for LPs forced some grandmas and grandpas to sell their interests at five, 10, or 20 cents on the dollar. APB published bids and widely distributed them via fax. It created an auction, kind of like e-Bay, that was more transparent. In 1998, APB became an Internet marketplace. APB raked in $5 million in commissions in its first year of operations, Finn says, and it is still active, although the vast majority of the LPs have been unwound and the secondary market is relatively quiet now (*Investment Advisor*, however, continues to publish actual secondary market prices for LPs at *www.investmentadvisor.com*).

Steve Finn

Though APB showed Finn’s dexterity, another business he started that same year has had more lasting power and would presage his entrance into the advisor custodial business. Finn says that as the partnership market continued to be devastated, he discovered in 1993 that it would be wise to start a trust company to complement his LP transfer agent business.

Forty percent of the LPs administered by Gemisys were in IRAs, and that meant the company was administrator to about 30,000 IRA accounts. Finn realized that by creating a trust company, he could pretty easily transition his business from just being a direct investment transfer agent to become an IRA custodian and administrator. The trust company initially held illiquid IRA investments and became known as a niche player in the IRA custody business because it would accept LPs, which was uncommon among trust companies. Hence, TCA was born.

Not long after starting TCA, Finn discovered the RIA custodial business. “It meant doing business with other businesses, which fit us well,” says Finn. Finn looked at what the competition—Jack White (which eventually merged with Waterhouse), Schwab, and DATAlynx—were offering. “We thought their technology was Mickey Mouse,” he says.

In 1995, TCA’s board decided to pursue the RIA business vigorously by putting to work his tech team from Gemisys on creating an RIA platform. That software was rolled out in 1997. In 2003, it was launched as an Internet platform. Along the way, TCA has lured $3.2 billion in advisor assets. That’s a tiny fraction of Schwab’s RIA assets, but the technology platform and commitment to providing service and support to a well-defined niche makes me think there’s room for TCA to succeed.

Finn estimates that about 2,000 RIAs are in TCA’s sweet spot, meaning they have at least $25 million in assets, use funds or ETFs, and base all of their client portfolios on groups of model portfolios. He has 75 advisors now.

“Schwab’s resources are massive,” he concedes, “and their technology for advisors is nice. But it is not all that impressive. If you compare their platform to ours, you see how they are trying to serve the entire market in the advisor business, while we are focused on a specific group and providing them a bundle of very specific services.”

“We’re looking for relationships with larger firms that are professionally managed and that have the ability and desire to grow,” says Finn. With 128 employees, 30 of whom are in the IT department, he can’t spread his staff too thinly. So he is looking to have fewer relationships but put more effort into helping each of them, which is why each client must generate $100,000 a year in revenue.

Running the Numbers

Which brings us to the different revenue model at TCA. While the other custodians get paid from a combination of mutual fund 12b-1 fees, a shareholder service fee on funds, and commission on trades, TCA cannot accept commissions because it is not a broker/dealer. It's a trust company. Instead, it charges a flat fee based on account size.

According to Jason Kling, a regional sales VP, TCA's fee works on a sliding scale of 28 to 35 basis points on client accounts of less than $250,000, 21 to 28 basis points on accounts of $250,000 to $500,000, 14 to 21 basis points on accounts from $500,000 to $1 million, and eight to 12 basis points on accounts of more than $1 million. If an RIA has 50 accounts valued at between $250,000 and $500,000 and 10 accounts with less than $250,000, then the 10 accounts would be charged between 28 and 35 bps for custody while the other would be charged 21 to 28 bps.

Keep in mind, however, that the break points are per account and not per client. So if a client has $200,000 in an IRA and $200,000 in a personal account, TCA does not combine the two accounts to levy that client's custody fee. Both of those accounts would be charged 28 to 35 basis points and not qualify for the 21 to 28 bps pricing on accounts of more than $250,000.

That may sound steep compared to the other custodians. However, if you are using no-transaction-fee funds with 12b-1 fees of 25 basis points, that can be applied against your custody fee. So can a shareholder service fee charged by a fund. Moreover, TCA's target clients are rebalancing against their models quarterly and many are active traders. Since there is no ticket charge on fund trades, that can amount to real savings. For instance, if you are paying a transaction fee of $25 per trade and have 30 transactions a year in an account worth $100,000, that's $750 a year on trans-

A SOLID PLATFORM

TCAdvisor II is Trust Company of America's Java-based online back-office platform for advisors to manage client account data; it has many of the same features offered by Fidelity, Schwab, and Waterhouse. TCA's browser-based application is the equivalent of the Big Three's data exchange and account management tools: SchwabLink, Fidelity's Advisor Channel; and TD Waterhouse's Veo. What's different about TCAdvisor II is that it is aimed squarely at assisting advisors who use model portfolios to manage their accounts. In addition, TCA says it will to do some custom programming to make it easier for advisors to work through its technology platform—a pledge consistent with its goal of differentiating its custodial business by providing more personal service to RIAs along with superior technology.

For instance, like other custodians, TCA account forms can be populated automatically with client data after you input the client information one time. So new-account forms, IRA beneficiary forms, and other paperwork with client data do not have to be re-keyed over and over again on TCA forms. But TCA also plans on going on step further.

Dirk Speyer, TCA's VP of national sales and product development, says TCA will turn an advisor's forms pre-populated. Speyer says an advisor's risk tolerance questionnaire, for instance, will be converted by TCA into a fillable PDF that clients and prospects could fill out on the Web, and then the advisor could export the client data into a customer relationship management application. So you would enter data once and TCA will program and convert your forms into automatically fillable PDFs. Speyer says TCA wants to allow advisors to capture data on prospects during the sales process and then use that data to fill TCA's account forms when the prospect becomes a client, so advisors could transfer account to TCA without re-keying all the data.

The TCA platform, which Speyer showed me in a demo, is focused on advisors that use model portfolios and then apply the strategies in those models to rebalance and trade client accounts. Block trades are driven off your models and don't require you to allocate them to each account. An advisor can apply multiple models to a single account, and can apply models to groups of accounts, such as all taxable or non-taxable accounts. When you raise cash in an account or groups of accounts, you can raise cash against your model and generate a trade order list. You can also set a variance level—the amount of deviation from your model that will be tolerated before a trade is automatically recommended by the system. Trading functionality is integrated into the platform.

TCA is trying to find RIAs who work as registered reps or solicitors. These asset gatherers can access the TCA platform and see only their book of business. The back-office system also lets an RIA automatically send a statement quarterly or annually to other advisors, such as a CPA or attorney.

Primary and secondary beneficiaries can be associated with individual assets on the custodial platform. TCA will also calculate the required minimum distributions on IRAs and an advisor can monitor whether clients have taken an RMD.

The application allows advisors to charge fees per client or create fee schedules at the investment strategy level or security level. It contains a memo feature to insert notes about individual clients, and it will remind of client tasks with an alert that pops up when you log in. The system also generates different views of your assets—by class, subclass, security type, and model, and you can view these reports for any date range. In addition, accounts can easily be combined to allow a household view.

TCA has also put limited portfolio performance reporting capabilities into the system. Speyer says an advisor could stop using portfolio reporting software, but admits that the level of reporting is basic. TCA does also offer a more elaborate reporting package separate from its back-office application and will print and mail reports to clients for advisors. But the reports are not customized. —*AG* action fees. If you're paying TCA 30 bps, it's only $300.

For RIAs that trade ETFs or individual stocks, the pricing is slightly different. Trades cost $25 plus 2 cents per share. Again, this sounds expensive at first. But say you have 100 clients in your "growth" strategy model portfolio and want to buy 100 shares of an ETF tracking emerging markets. Some custodians might charge you $10, $20, or even $25 to trade each client's account—that could be between $1,000 and $2,500 in trading charges, says Kling. TCA will charge a $25 ticket charge, plus two cents per share, or $200. Keep in mind that you still have to pay the custody fee on top of this amount, however.

Competitive Fees

For an advisor that is rebalancing accounts a couple of times a year and making some trades between quarters, Finn says the fees are in line with the competition. "I've sat in on 90% of the closed deals with advisors, until the past year" says Finn, and we do not lose business because of our fees."

To take TCA to the next level, Finn last August removed himself from day to day management as CEO and replaced himself with D. Terry Reitan, who had been President and CEO of Fiserv's Investment Support Services division. In addition to being one of the largest independent trustees of self-directed IRAs, Fiserv ISS includes DATAlynx, which custodies $14 billion for 430 RIAs; over all, Fiserv ISS has more than 300,000 accounts and $36 billion under management. With Reitan moving to run a company about a tenth the size of ISS, you have to believe this is a serious effort to scale TCA way up in size.

Providing service to RIAs is not easy. Providing outstanding service is difficult for any company and requires ongoing discipline and lasting power. Providing outstanding service to a niche group, however, seems doable. It will be interesting to see over the next year or two if TCA can execute its plan, convincing advisors to switch to its platform to gain better service and technology assistance, and to see if it helps its RIAs grow their businesses. It remains to be seen if TCA's pricing model will work. But its focus on a niche and the technology platform it has built to serve that niche is intriguing and will be fun to watch. IA

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