

A blurred background image of a financial chart with multiple colored lines (white, yellow, red, blue) and a dotted trend line, set against a dark blue gradient.

PRIVATE WEALTH: GETTING THE MOST OUT OF YOUR CUSTODIAN

March 2020

PRIVATE WEALTH: GETTING THE MOST OUT OF YOUR CUSTODIAN

NEPC's Private Wealth

March 2020

For our high-net-worth clients, choosing a custodian and a custody arrangement are among the most important decisions they will make to streamline the complex process of managing their wealth.

When selecting a custodian—a financial institution that holds clients' securities for safekeeping in order to minimize the risk of theft or loss—it is not only vital to ensure that the firm has the technological and reporting capabilities required, but also the stability and flexibility to meet the custodial needs unique to every family office. At NEPC, we work closely with you and your family office to help you find the right fit for your individual and unique custodial needs.

First, let's discuss the fundamental responsibilities of a custodian. They are:

1. Safekeeping of a client's financial assets and securities
2. Ensuring clear title and immediate access to assets
3. Ensuring ownership records are held in a secure environment

A custodian holds securities and other assets in electronic or physical form. Custodians generally tend to be large and reputable firms due to the sheer size of the assets and securities they are responsible for.

WHAT TO EXPECT FROM YOUR CUSTODIAN?

The first and most imperative function of the custodian is to ensure the safety of clients' assets. These assets should be protected from any institutional risk and properly segregated from the assets of other investors and the custodian's assets. Clients should be assigned a dedicated service team responsible for the day-to-day administration and servicing of their accounts.

In addition to daily operational responsibilities, for instance, the settlement of direct trades, income and principal-collection services, cash disbursement and proxy voting, the custodian provides clients with a monthly or quarterly statement detailing the assets held on the client's behalf in addition to any income or transactions that occurred. In addition to safeguarding the client's money and investments and sending an account statement, the custodian also serves as the facilitator or intermediary when investments are bought or sold.

At year end, the custodian files all government forms, and provides a 1099 Composite and Account Summary, including realized gains and losses. The custodian may also provide additional tax information, which can be helpful for the family office or outside accountants responsible for preparing the family's taxes.

WHAT ARE THE AVAILABLE OPTIONS?

Custodial services can generally be provided by a bank or a broker/dealer, either by engaging directly with that institution or, in some cases, by delegating that responsibility to the investment managers in the family's portfolio. Although needs may differ from one family to another, we have found that most families and family offices choose to establish a single direct master custodial relationship with a bank. In this paper, we will focus primarily on this service model.

It is not only vital to ensure that the firm has the technological and reporting capabilities required, but also the stability and flexibility to meet the custodial needs unique to every family office.

When providing custody services, custodians act solely on instructions from their clients; they do not exercise any discretion over the use or reuse of client assets under custody, nor do they use them for their own purpose.

Assets held in custody by a bank-chartered custodian are not the bank's assets. Consequently, the failure of the underlying securities. Note: this

a custodian is unlikely to result in a loss of structure may differ with a broker/dealer.

WHAT SERVICES DOES A CUSTODIAN PROVIDE?

The services of a custodian can generally be classified into two main categories: core custody services and ancillary services.

CORE CUSTODY SERVICES

These services include:

1. Safekeeping of assets and securities, for instance, stocks, bonds and commodities such as precious metals and currency
2. Arrange settlement of purchases, sales and deliveries in and/or out of such securities and currency
3. Collect information on and income from such assets—dividends in the case of stocks and coupon payments in the case of bonds—and administer related tax withholding documents and foreign tax reclamation
4. Administer corporate actions on securities held such as stock dividends, stock splits, mergers, tender offers, and bond calls.
5. Provide information on the securities and their issuers for events such as annual general meetings and related proxies
6. Maintain currency and/or cash bank accounts, process deposits and withdrawals, and manage other cash transactions
7. Perform foreign exchange transactions

8. Provide a holistic view of a client's financial position, including non-custodial assets, streamlined reporting, trade execution, and hedge fund and private equity administration.

ANCILLARY SERVICES

In addition to core custody services, many custodians also offer additional financial services such as:

1. Securities lending
2. Partnership accounting
3. Financial statement preparation
4. Tax return and K-1 preparation
5. Performance reporting
6. Corporate trustee services
7. Assistance with family governance
8. Wealth and estate planning

WHAT TO LOOK FOR IN A CUSTODIAN?

Engaging an experienced and reputable master global custodian with a strong balance sheet is generally preferable to spreading assets among several custodians. In addition to the standard operational responsibilities, custodians should have a risk management program in place, including safekeeping of assets, protection against institutional risk, disaster recovery and data backup plans, information security, investment and administrative risk controls, and cybersecurity.

It is important that custodians are committed to ongoing investments in their technology platforms as client needs and technology solutions evolve.

Another requirement of a good custodian is the accuracy and timeliness of data. Regardless of the number of investment managers held in a family's portfolio, the custodian should have the ability to capture all the relevant data for every single transaction across every single account. A fully accrued and trade-dated consolidated monthly report, including tax lot level, should be available on a timely basis after the end of each month. Annual 1099 tax reporting should also be available on a timely basis for assets held in custody.

In a world of constant change and an endless flow of information, families are also looking for 24-hour access to their financial data. Top-tier global custodians are able to provide an array of services through sophisticated online systems. It is important that custodians are committed to ongoing investments in their technology platforms as client needs and technology solutions evolve.

CONCLUSION

Custodians play a critical role in helping families guard and preserve their wealth. Clients should select a custodian with strong fundamentals and the financial resilience to withstand challenging market conditions. A good custodian should not be just another provider, but an extension of the client's business and/or family office. The NEPC Private Wealth Team is here to help you with any questions you may have regarding your custodian or your custodial arrangement. We can also conduct a comprehensive review of your custodian(s).

REFERENCES

Family Office Custody: Many Models, One Solution. BNY Mellon Wealth Management, January 2018.

Insights on Family Office Services: Global Custodian, Asset Servicer, Master Custodian – What's in a Name? Northern Trust, January 2013.

DISCLAIMERS AND DISCLOSURES

- *Past performance is no guarantee of future results.*
- *All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.*
- *The information in this report has been obtained from sources NEPC believes to be reliable. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.*
- *The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.*

