

A DUE DILIGENCE PROCESS IS FOLLOWED IN SELECTING SERVICE PROVIDERS, INCLUDING THE CUSTODIAN.

Custodial selection is a very important fiduciary function. As with other prudent practices, there are a number of important decisions that need to be managed. The role of the custodian is to: (1) hold securities for safekeeping, (2) report on holdings and transactions, (3) collect interest and dividends, and, if required, (4) effect trades.

At the retail level, the custodian typically is a brokerage firm. Most securities are held in street name, with the assets commingled with those of the brokerage firm. To protect the assets, brokerage firms obtain adequate and appropriate insurance. Most institutional investors choose to use trust companies as custodians and pay an additional custody fee. The primary benefit is that the assets are held in a separate account, and are not commingled with other assets of the institution.

Suggested Procedure

If a client's account is being implemented with a separate account manager, the custodian will likely open a money market fund to serve as the sweep vehicle for dividends and income. The Advisor should inquire as to whether the sweep vehicle is the retail money market fund for the custodian, or the institutional fund. The expense ratio differential between the two can be substantial. If the lower cost alternative is available, ensure that it is implemented.

Many custodians can provide the Investment Advisor information on portfolio performance and tax reporting. Advisors should inquire about the availability even if they are planning to produce the reports in-house. There are numerous ways an error can be made in preparing a performance report, and an additional report, from either a custodian and/or money manager, can make it easier for the Advisor to identify where an error has been made.

Substantiation

Employee Retirement Income Security Act of 1974 [ERISA]

§402(a)(1); §402(b)(2); §404(a)(1)(B)

Other

Interpretive Bulletin 96-1, 29 C.F.R. §2509.96-1; DOL Information Letter, Qualified Plan Services (7/28/98); DOL Information Letter, Service Employee's International Union (2/19/98)

Uniform Prudent Investor Act [UPIA]

§2(a); §7; §7 Comments; §9(a) (1), (2) and (3)

Uniform Prudent Management of Institutional Funds Act [UPMIFA]

§3(b); §3(c); §5(a)

Management of Public Employee Retirement Systems Act [MPERS]

§6(a) and (b)(1) and (2); §7

CRITERIA

- 3.4.1 A documented due diligence process is applied to select the custodian and all other service providers.
- 3.4.2 Each custodian has appropriate and adequate insurance to cover each client's portfolio amount.
- 3.4.3 An appropriate sweep money market fund is selected.
- 3.4.4 An inquiry has been made as to whether each custodian can facilitate performance reporting and year-end tax statements.