



JUNE 2025 CLIENT QUESTION OF THE MONTH: WHAT IS A QUALIFIED CUSTODIAN? HOW THEY SAFEGUARD YOUR INVESTMENT ASSETS

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When it comes to safeguarding your financial assets, understanding the role of custodians is imperative. These institutions serve as the backbone of asset protection, making sure your securities and cash are held securely and accurately recorded. In this client question, we delve into what makes custodians indispensable to the financial system, the protections they provide, and the regulatory framework that governs their operations. Whether it's preventing theft, managing risk, or fostering confidence in the financial system, qualified custodians are pivotal to the integrity and stability of your investments, and as such play an important role in helping you meet your financial objectives.

What is a Custodian? What do they do?

When Winthrop Wealth refers to custodians, we're referring to financial institutions such as LPL, Charles Schwab, or Fidelity. These are qualified custodians, i.e., highly regulated financial entities responsible for safeguarding clients' cash and securities. They ensure the security and accurate recording of assets, protecting them from theft, misuse, and loss due to insolvency or activities of investment firms. While custodians do not mitigate investment losses or market fluctuations, custodians play an essential role in keeping your assets safe, providing transparency, and supporting the stability, integrity, and efficiency of the financial system.

Qualified custodians have legal and regulatory standards, and responsibilities set by and subsequently regulated by the Securities and Exchange Commission (SEC) and a combination of other entities depending on the type of institution (bank or non-bank), including but not limited to:

- **Securities and Exchange Commission (SEC)** – Regulates and maintains orderly and efficient securities markets through rule making, oversight and enforcement. The SEC primarily regulates registered investment advisors, securities issuers, exchanges, and markets.
- **Financial Industry Regulatory Authority (FINRA)** – Oversees the operational and ethical conduct of broker-dealers through rulemaking and enforcement.
- **Securities Investor Protection Corporation (SIPC)** – Provides limited protection of up to \$500,000 per eligible account (including \$250,000 for cash) in the event a broker-dealer custodian fails. This coverage does not protect against investment losses.
- **Office of the Comptroller of the Currency (OCC)** – Regulates national banks and ensures they meet fiduciary standards and operational requirements.
- **Federal Deposit Insurance Corporation (FDIC)** – Seeks to ensure stability and public confidence in the banking system through supervision, insuring deposits, and managing receivership of any failed banks.
- **The Federal Reserve & State Banking Regulators** – Provide additional oversight, focusing on areas such as capital requirements, risk management, and the segregation of client assets from the bank's own holdings.

Most qualified custodians are part of larger, multi-faceted businesses that incorporate or are affiliated with a broker-dealer, registered investment advisor (RIA), and in some cases depository banks or insurance brokers.

What Happens if a Custodian Goes out of Business?

Like any business, custodians can fail. Fortunately, if a custodian fails, client assets are generally protected and transferred to another trusted custodian, as financial regulations mandate the segregation of client holdings from the custodian's own assets.

Lehman Brothers Collapse (2008) Example

When Lehman Brothers, once the 4th largest investment bank, went out of business and declared bankruptcy on September 15th, 2008, it sent shockwaves through the global financial system. The firm's collapse, driven by excessive leverage, exposure to the subprime mortgage market, and risk management failures, became a defining moment of the financial crisis and raised serious concerns for investors about the safety of their assets.

What This Meant for Their Clients:

- Most client accounts were protected – Due to regulatory requirements mandating the separation of client and firm assets, the majority of customer holdings were safely transferred to other institutions, including Barclays Capital Inc.
- SIPC played a key role – The Securities Investor Protection Corporation (SIPC) initiated the liquidation proceeding under the Securities Investor Protection Act (SIPA) to help facilitate the transfer of client accounts and minimize market disruption. By 2022, the liquidation returned over \$115 billion to customers and creditors, without the use of SIPC funds.
- However, some investors still faced losses – Clients who owned Lehman-issued securities such as structured notes or corporate bonds were subject to the bankruptcy process. These assets, unlike custodied third-party investments, were tied directly to Lehman's financial health and faced delays, devaluation, or permanent loss.

Even in extreme cases like Lehman's failure, the regulatory frameworks around custody helped protect investors. This highlights the importance of a qualified custodian and understanding that all investing involves risk, including loss of principal.

Winthrop Wealth's Lessons:

- The robust regulatory and oversight regime for custodians, while complex, has a track-record of working well to see clients assets are well protected.
- There is a myriad of factors that go into the choice of custodian for a client. Whenever a client's specific circumstances allow, Winthrop Wealth strongly prefers that clients work with custodians with limited exposure to speculative markets, and unsecured products issued by the custodian.

What Protections Can I Expect with Regard to Investment Accounts?

While no investment is protected from market-related losses, qualified custodians must adhere to numerous regulations, standards, and laws that are intended to protect client assets, such as:

- Assets held by a custodian must be segregated from the custodian's general accounts such that client assets are protected from the custodian's creditors. In addition, client assets must be indemnified against losses resulting from a custodian's actions.
- Custodians must maintain procedures, processes, and policies to safeguard client assets.
- They are required to provide account statements at least quarterly.
- Written Agreements must outline responsibilities, obligations, and fees. Furthermore, custodians must disclose any conflicts of interest they may have.
- Specific accounting, recordkeeping, reporting requirements, not only to clients regarding their accounts, but also to governmental agencies, such as the IRS.
- Custodians are subject to regular audits to assess compliance and internal controls.

What other protections may apply?

It is important to be aware that investment vehicles, such as stocks, bonds, ETFs, and similar, are not FDIC-insured. However, under certain circumstances, these assets may be insured by the SIPC.

SIPC Protection: Congress created Securities Investor Protection Corporation in 1970 to protect clients of member broker-dealers that may fail financially, be liquidated, or are otherwise unable to meet obligations to securities clients. If any securities or cash are missing from eligible client accounts, SIPC steps in and, within certain limitations, works to return clients' cash, stock, and other securities held at the firm. SIPC does not protect against losses from the rise and fall in the market value of investments. SIPC membership provides account protection up to a maximum of \$500,000 per customer, of which \$250,000 may be claims for cash. For more details, visit www.sipc.org.

Excess of SIPC Coverage: Many firms, including LPL Financial, provide additional coverage beyond SIPC limits through private insurers.

Additional insurance coverage may apply, such as professional liability, fidelity insurance, or cybersecurity insurance to cover specific events. Note, none of these policies do not protect against investment risk.

Why A Qualified Custodian Matters: The Madoff Example

The importance of an independent, qualified custodian became clear after one of the most notable fraud cases in financial history, the Madoff Scandal. Bernie Madoff operated both as a legitimate market-making business and an investment advisory firm – one that ultimately turned into a massive Ponzi scheme. A key factor that allowed the fraud to continue undetected for so long was the lack of a qualified custodian and proper regulatory oversight.

Without customer accounts being maintained by a qualified custodian and not being subject to thorough audits or oversight, Madoff was able to falsify records by creating fraudulent account statements and asset values, misleading investors for many years. The fraud was exposed in 2008, with losses exceeding \$65 billion, making it the largest Ponzi scheme in history. For more details, please visit the FBI website [here](#).

The Madoff scandal led to more financial regulation and a focus on protecting and educating investors.

Lessons learned from Madoff & Importance of Independent Custodians:

- Investors should understand where their accounts are custodied. Visit Investor.gov for additional resources, such as [Investor Bulletin: Custody of Your Investment Assets](#).
- The SEC maintains the [Investment Adviser Public Disclosure website](#) to research investment advisors, their representatives registration, and any disciplinary history.
- FINRA maintains [FINRA Broker Check](#) for due diligence on brokers or broker-dealers.

Winthrop Wealth's Lessons:

- We work exclusively with qualified custodians, such as LPL Financial and Charles Schwab, that are independent and subject to regulatory oversight.
- Investors should be able to independently verify holdings and account activity through a reputable custodian. At Winthrop Wealth, clients receive third-party account statements directly from their custodian, in addition to our detailed performance reports, adding an important layer of transparency and protection.

Winthrop Wealth's Take:

Winthrop Wealth believes that clients are best served when they have qualified custodians to safeguard their assets, enabling us to concentrate on our fiduciary responsibilities in providing investment and financial planning services. To that end, we have cultivated a long-term relationship with LPL, collaborating to deliver an experience that aligns with Winthrop Wealth's mission to help – our people, clients, and advisors – live life to the fullest.

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