THE Wealth REPORT

The banking industry wobbled in March following the closure of multiple banks. Fortunately, protections exist for investors and their assets if a brokerage firm or investment bank fails.

PROTECTING YOUR ASSETS

Regulations provide protection after a brokerage firm closure

Overview

Silicon Valley. Signature. Credit Suisse. Deutsche Bank. In early March, several large financial institutions buckled under the combined weight of too many depositor withdrawals and varying levels of mismanagement. The banking industry found itself under intensified scrutiny, with Americans concerned that a larger crisis was at hand for the U.S. financial system.

Many also wondered if the recent banking struggles could extend into brokerage firms, which hold trillions of dollars in investor assets. Although brokerage firms can fail, examples of this happening are few and far between. If they do close unexpectedly, however, investors have some basic protections for their money in place.

Here, we'll answer some of the questions we've received from clients about their investments at brokerage firms.

Has an investment bank or brokerage ever failed?

Unfortunately, yes. During the Great Recession of 2008-09, investment bank and brokerage firm Bear Stearns went bankrupt and was ultimately purchased by JPMorgan Chase & Co. Another notable firm, Lehman Brothers, crashed soon after. Once thought "too big to fail," Lehman Brothers was the fourth-largest investment bank in the U.S. before it closed.[1] Both banks were casualties of the subprime mortgage crisis, which resulted in the housing bubble bursting.

Aren't these financial institutions regulated?

They are. Most investment banks are under the watchful eye of two separate regulatory agencies. The U.S. Securities and Exchange Commission (SEC) sets rules about how firms handle assets under management. The Financial Industry Regulatory Authority (FINRA) monitors organizations and their representatives (such as advisors) to make sure everyone is staying compliant with those rules.

Finally, the Securities Investor Protection Corporation (SIPC) insures investments and handles the transfer of assets should a brokerage firm or investment bank fail. Formed under the Securities Investor Protection Act of 1970, the SIPC is not a regulatory agency. Instead, it's a membership organization, made up of U.S. brokerage firms and investment banks.[2]

Does that mean my investments are insured?

Some of them are. If an institution fails or shows signs of trouble, the SIPC insures a total of $500,000 in assets for each investor. The SIPC limits its protection to $250,000 in cash; the protection also extends to certain securities, such as stocks and bonds.[3]

The SIPC's $500,000 limit can be tricky to navigate. Let's say John Smith holds two individually owned brokerage accounts at Firm A, totaling $1 million in cash and securities. These accounts are known as "same capacity," since they are both brokerage accounts. If Firm A fails, 50% of John's assets are covered by the SIPC. But if John owns same capacity accounts at Firm A and Firm B, he is covered for up to $500,000 at both institutions (for a total of $1 million in coverage).

If a customer owns accounts in a "separate capacity," then they could qualify for additional SIPC protection. For example, if John and his wife, Mary Ellen, have additional assets in a jointly owned account, that account qualifies for another $500,000.[4] The SIPC provides these examples of separate capacities:

- Individual account
- Joint account
- An account for a corporation
- An account for a trust
- An individual retirement account (IRA)
- A Roth individual retirement account
- An account held by an executor for an estate
- An account held by a guardian for a ward or minor[5]

What the SIPC does not do is protect investors from market losses during a downturn. Their protection also doesn't extend to more complex types of investments, such as commodity contracts or hedge funds. Fixed annuities also don't fall under SIPC's protection. Instead, annuity contracts are backed by the financial strength and claims-paying ability of the issuing insurance company.*

So how do I know my invested money is preserved with a brokerage firm?

A financial institution failure doesn't happen overnight; there are typically signs that trouble is brewing way in advance. If it appears that a failure is looming, an agency such as FINRA will step in to help transfer assets to another registered firm. And the SIPC protection will apply if customers lose assets due to the failure.

Additionally, the SEC requires financial firms to segregate their own assets from customers'. This is to keep firms from potentially using investors' funds for their own purposes (either intentionally or unintentionally).

Final Thoughts

While regulatory agencies provide oversight, investors can also take steps to make sure their assets are protected. You can find out how a brokerage firm or investment bank is performing by accessing their company filings at www.sec.gov. It's also best practice to only use brokerage firms or investment banks with a well-established track record and solid reputation.

Your financial advisor also serves as a good source of information about the financial institutions holding your assets. We encourage you to contact them anytime you have questions or concerns about your individual investments and the brokerage firm they use as a custodian.

[1] Nick Lioudis. Investopedia. March 10, 2023. "The Collapse of Lehman Brothers: A Case Study." https://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp. Accessed March 26, 2023.
[2] SIPC. "About SIPC: Who We Are." https://www.sipc.org/about-sipc/. Accessed March 27, 2023.
[3] SIPC. "Mission." https://www.sipc.org/about-sipc/sipc-mission. Accessed March 26, 2023.
[4, 5] SIPC. "Investors with Multiple Accounts." https://www.sipc.org/for-investors/investors-with-multiple-accounts. Accessed March 26, 2023.

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