

Amid Brokers' Woes, Investor Accounts Are Mostly Protected

By Jane J. Kim

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Wall Street Journal - Investors with brokerage accounts are asking themselves a simple question: Is my account in jeopardy?

The good news is that account holders at Bear Stearns Cos., Lehman Brothers Holdings Inc. or, for that matter, any of the other brokerages that are under assault can rest assured that their money should -- with a few exceptions -- be safe.

Bear Stearns averted filing for bankruptcy by agreeing to sell itself to J.P. Morgan Chase & Co., which will assume the firm's trading obligations. As a result, clients with brokerage accounts at Bear, which is mainly an institutional firm but oversees some individual assets, will eventually see their accounts and assets transferred to J.P. Morgan. Like Bear, Lehman Brothers, which saw its stock tumble by 19% yesterday amid concerns the investment bank may also face funding problems, caters mostly to wealthier individual investors.

But Bear's situation raises concerns about what could happen to individual investors if a major brokerage firm goes under. Fortunately, the system of regulatory rules in place should protect most investors.

"I really don't think it's that big a deal for retail customers," says Adam Honore, a senior analyst at Aite Group LLC, a financial-services research and advisory firm. "Crisis and liquidity have nothing to do with whether you've got an IRA with Bear Stearns."

For one, brokerage firms are required to have enough assets on hand to repay any customer obligations in the event of a bankruptcy. Moreover, under the Securities and Exchange Commission's so-called customer-protection rule, broker dealers are required to hold client assets in "segregated accounts," which means the firm cannot use those assets for their own business purposes.

To the extent that the firm doesn't have the funds and securities to cover those claims -- either because of misappropriation or negligence -- the Securities Investor Protection Corp. will step in to cover losses up to \$500,000 per account, including \$100,000 for claims for cash. Beyond the SIPC coverage, some brokerage firms may offer additional insurance.

Investors worried about their brokerage firm should verify that it has SIPC coverage and determine what the firm's excess coverage might be, says Steven Caruso, a partner at Maddox Hargett & Caruso PC, a New York law firm. Investors with accounts that exceed those limits could be at risk of losing their money, he says.

Some brokerage firms have taken the initiative to reassure clients that their money is safe. Citigroup Inc.'s Smith Barney unit, for example, recently distributed information about the various laws and protections available to all investors to its financial advisers and branch managers.

Some investors, however, could take a hit in the event of a bankruptcy. In cases where investors had taken out margin loans, the firm could demand immediate repayment, forcing investors to sell their securities at a loss, Mr. Caruso says. Investors who hold the firm's own proprietary investment products, such as the firm's own hedge funds, could also face difficulties in selling their investments if a firm goes under. "Your ability to liquidate that position is going to be limited, if it exists at all," he says.

In general, any securities that a customer holds at a brokerage firm are legally the investor's property -- and aren't exposed to the claims of the firm's creditors. But while investors still own those underlying holdings, they may have trouble trading them in the event of a bankruptcy because of a disruption in service, says Rob Hegarty, managing director at TowerGroup in Needham, Mass. Investors also aren't protected against a decline in market value of the securities they own, he adds.

Many brokerage-firm clients also have their uninvested cash automatically swept to a bank-deposit account or other cash alternative. If cash is swept to a bank savings accounts, the funds have up to \$100,000 in coverage from the Federal Deposit Insurance Corp. Cash that is swept into a money-market mutual fund is covered by the SIPC.

While there have been occasional situations where brokerage-firm customers didn't get their money back, those have been mainly limited to small broker-dealer firms, some of which may have dealt in lightly regulated penny stocks, experts say. In the past five years, there have been seven brokerage firms, mostly small ones, that were liquidated, according to the SIPC.

When major brokerage firms collapse, as did Drexel Burnham Lambert Inc. in 1990, the firms often sell their customer accounts to other firms before they are liquidated. "In Drexel's situation, the only customers who were not made whole were the customers that Drexel literally could not find," says Stephen Harbeck, president and chief executive of the SIPC. "Because Drexel had properly segregated all of its customer assets, it was not necessary for SIPC to become involved."