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Should You Worry?

If Your Brokerage Firm Goes Broke, Will It Take Your Savings Down With It?

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Kevin, with all the news about brokerage firms failing, and banks under pressure, should I stuff my savings under the pillow?

Nancy from Las Vegas

Recent news about brokerages has been bad. Most notably, Bear Stearns, one of the oldest investment banks on Wall Street, was preparing a bankruptcy filing when, for the first time in history, the Federal Reserve stepped in to negotiate and support a rescue by another bank, JP Morgan Chase. With these headlines and issues, should you be worried about your brokerage firm going bankrupt and taking your investments down with it? Let's check this out:

First, your investments in stocks and bonds are independent of the financial status of your brokerage firm. For example, if you own 1,000 shares of General Electric and your broker goes broke, you still own 1,000 shares of GE. That alone should make you breathe a little easier.

Second, brokerage firms are under the insurance umbrella of the SIPC (Securities Investor Protection Corporation), created by Congress in 1970. In the event of failure of a member firm, the SIPC membership provides protection of up to $500,000 for each investor, of which up to $100,000 can be in cash. SIPC is fundamentally different than FDIC (see below) in that depositors in a bank by definition are looking for safety of principal.

Investors in the stock market recognize that rewards are only possible with risk. Most market losses are a normal part of the ups and downs of the world of investing. That is why SIPC does not bail out investors when the value of their stocks, bonds and other investments falls for any reason. Instead, SIPC replaces missing stocks and other securities where it is possible to do so. SIPC does not cover individuals who are sold worthless stocks and other securities. SIPC helps individuals whose money, stocks and other securities are stolen by a broker or put at risk when a brokerage fails for other reasons. Certain investments are not covered by SIPC, such as commodity futures contracts, fixed annuity insurance contracts, currency, and others. Click here for more information about SIPC.

And finally, most brokerage firms buy additional insurance above and beyond SIPC insurance. Call your brokerage firm and inquire about additional insurance if you have more than the SIPC limits invested with your broker.

What about banks? Banks carry FDIC (Federal Deposit Insurance Corporation) insurance. The FDIC was created in 1933 in response to the thousands of bank failures that occurred in the 1920s and early 1930s.

Most bank customers believe that their deposits are insured up to $100,000.

But that number does not apply in many cases. For example, let's say a married couple, Jim and Mary, have $250,000 on deposit with a bank, some of it in a joint checking account and some in a joint savings account. Jim and Mary qualify to have $100,000 of their deposits insured each giving them a total of $200,000 in coverage. Still, they have $50,000 exposure should their bank fail.

A simple solution for Jim and Mary would be for them to move at least $50,000 to a different bank with FDIC insurance.

Another example would be IRAs. IRAs carry $250,000 of insurance per individual insured. Click here for a detailed description of how FDIC insurance works.

Credit Unions: Credit Unions operate under the NCUA, which is similar to the FDIC. Click here to read more about credit union protection.

So, Nancy, while all the news may be unsettling, in most cases there is some sort of federally mandated insurance.

Do your homework. Confirm that your stockbroker or financial planner's broker/dealer is a member of SIPC. If applicable, ask if they have additional insurance above the limit. If you have more than the FDIC limit at a bank, consider moving part of your deposits to another bank.

If you follow these simple steps, you have probably covered your bases in terms of account protection.

Kevin Bourke is a registered principal with and offers securities through LPL Financial, Member FINRA/SIPC.