SMS Capital Management, LLC

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"Am I Covered?"

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By Steven M. Sheldon, CFA

Concerned investors have come to realize that these days practically no company is invincible. So what would happen if the recognizable brokerage/mutual fund company you use were to fold and go out of business? Would your cash, mutual funds, stock and bond holding be at risk? Or, would some type of insurance cover you?

Most people are aware that in the event of a bank failure, deposits held with Federal Deposit Insurance Corp. ("FDIC") insured banks are covered for balances up to $100,000. The FDIC is a government agency, which means the $100,000 is ultimately backstopped against the credit risk of the U.S. government. But, what about non-deposit related holdings such as individual securities, mutual funds, and other similar types of investments held in brokerage accounts? These types of investment holdings ARE NOT covered by the FDIC.

Government Doesn't Cover Risk Takers

Most large brokerage firms get insurance for client accounts from a company known as the Securities Investor Protection Corporation ("SIPC"). The SIPC, however, does not provide the same type of insurance as the FDIC. For starters, the SIPC is not a government agency. It is a non-profit, membership corporation funded by its member securities broker-dealers. Another notable difference is that the SIPC does not provide the same type of blanket protection provided by the FDIC. When a member bank fails, the FDIC provides a no-questions-asked approach to coverage for up to the $100,000 limit. The SIPC, on the other hand, does not bail out investors when the value of their stocks, bonds and other investments fall for any reason. SIPC insurance only comes into play when investors' cash, stocks and other securities are stolen by a broker or put at risk when a brokerage fails or becomes insolvent for other reasons. Without SIPC, investors might lose their securities and money or expend a lot of time, effort and resources trying to recover their assets in bankruptcy court proceedings.

SIPC offers protection for up to $500,000 per account (including cash claims limited to $100,000). Some brokerage firms provide additional coverage through a third-party carrier to supplement its SIPC coverage to protect account holders with larger holdings.

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Investment Limitations

Not all investments are eligible for SIPC protection. SIPC does not cover commodity futures contracts, fixed annuity contracts, and currency, as well as investment contracts (such as limited partnerships) that are not registered with the U.S. SEC under the Securities Act of 1933.

Even though the SIPC is not equivalent to having the guarantee of the U.S. government and some assets are excluded from coverage, the insurance still offers investors some degree of protection and comfort.

How to Protect Yourself

In the event that your brokerage firm does abscond with your money or fails for other reasons, what types of things can you do to expedite recovery of your assets?

First, make sure that your brokerage firm is a "Member SIPC" and provides SIPC coverage for its clients as a result. Your brokerage firm should provide this information. If you have a question as to whether or not a particular firm is a member of SIPC, you may call the SIPC membership Department at (202) 371-8300.

Second, make sure you keep accurate and current records of your account holdings and transactions. Although the SIPC and court-appointed trustees will have access to the brokerage firm's records, there may be instances where the records are unavailable or inaccurate. In that event, the onus is on you to prove what you really had in your account.

How Much Protection Do SMS's Clients Have?

SMS selected Fidelity Investments' Institutional Brokerage Group ("IBG") as custodian for its clients' accounts. With more than 53 million customer accounts and $1.5 trillion in assets under management, Fidelity Investments has grown to be one the most widely recognized names in financial services (assets invested through IBG are held in custody with National Financial Services LLC, a Fidelity Investments Company).

All accounts with National Financial Services (Fidelity) have SIPC's standard coverage of up to $500,000 (limited to $100,000 for claims in cash) and unlimited securities protection, in excess of SIPC coverage, through private insurance coverage provided by Fidelity for accounts holding securities worth more than $500,000.

In addition, SMS retains copies of its clients account records, statements, and transaction history in a secure location.