Securities Investor Protection Corporation (SIPC)

The Securities Investor Protection Corporation (SIPC) is a non-profit, non-government, membership corporation, funded by its member broker-dealers. Most U.S. broker-dealers are required to belong to SIPC. SIPC was created under the authority of the Securities Investor Protection Act of 1970, (SIPA).

The SIPA was the response by Congress to an unexpected surge, in the late 1960s, in the average daily trading volume. This sudden increase in trading activity, combined with a sharp drop in securities prices, overwhelmed the transaction processing systems then in place, leaving many brokerage firms unable to determine their own financial situation. The operational chaos lead to a number of broker-dealers being acquired or merged into other firms or simply being liquidated and going out of business. Public confidence in the financial markets was severely shaken.

What Does SIPC Coverage Actually Do?

The protection offered by SIPC has sometimes been compared to that offered by the Federal Deposit Insurance Corporation, or FDIC, although the comparison is misleading. When a member bank fails, the FDIC insures all depositors at that bank against loss. There are no questions asked and an individual depositor is made whole, dollar-for-dollar, up to a specified dollar limitation.

SIPC, however, is designed to simply *replace* missing stocks and other securities (when possible), even when an investment may have increased or decreased in value. SIPC does not protect investors when the value of their stocks, bonds, or other securities declines in value, whatever the reason.

SIPC protects customers up to $500,000 per insured account for securities and cash, with a $250,000 limit for cash only.

How SIPC Insurance Works

When a brokerage firm fails, the steps SIPC will take to protect investors will vary, depending on the size of the broker-dealer and whether or not the firm's account records are accurate or not. In general, the procedure is as follows:

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- **Liquidation – first steps:** For larger firms, a court-appointed trustee works with SIPC to liquidate a failed broker-dealer. If the brokerage firm has accurate records, some or all of the accounts may be transferred to other brokerage firms. In other situations, and after reviewing the broker-dealer's account records, the trustee will mail *notices* and *claim forms* to all customers who had accounts with the firm within the previous 12 months. Securities claimed by an investor are valued for purposes of the $500,000/$250,000 limits as of the date the liquidation began, known as the "filing" date.

- **Liquidation – claim form process:** To be eligible for SIPC protection, an investor must submit a completed claim form to SIPC, showing the securities, cash, and other amounts the investor claims are owed to him or her by the failed broker-dealer. The claim form should be accompanied by supporting documentation such as brokerage statements, trade confirmations, and any correspondence with the firm. SIPC will then compare the claim with the books and records of the broker-dealer and determine the investor's "net equity," the difference between what the broker-dealer owes the investor (such as securities and cash) and what the investor owes the broker-dealer, (such as a margin loan).

- **Liquidation – determination letter:** After receiving an investor's claim, SIPC will decide if the claim should be allowed or rejected. A *Determination Letter* is sent to the investor explaining SIPC's decision. If the investor does not agree with the decision in the determination letter, he or she has 30 days to object, in writing, to the court supervising the liquidation.

- **Liquidation – distribution of cash and securities:** If an investor agrees with the determination made by SIPC, the securities and cash that he or she own are returned. The goal is to put customers in the same position – in terms of *what* is owned - they were in before the broker-dealer failed. The *value* of those securities, however, is not guaranteed. In the interim period, market movements may have increased or decreased the value of a customer's securities. In some situations it may not be possible to return all of the securities that were in the account.

- **Direct Payment Procedure:** In situations involving smaller broker-dealers, SIPC may use an out-of-court process known as a *Direct Payment Procedure*. SIPC sends claim forms to customers and publishes notice of the Direct Payment Procedure in one or more newspapers. Securities are valued as of the date the notice is published in the newspaper. Customers have six months to submit their claims to SIPC. Claims submitted are reviewed by SIPC and a determination is made. If a customer disagrees with SIPC's determination, he or she has six months to ask for judicial review of the determination.

Other Points to Keep in Mind

There are several other points to keep in mind:

- **Some "securities" are not protected:** SIPC offers protection to securities as defined in the SIPA. Under the SIPA, some investments commonly thought of as being securities are not protected by SIPC. For example, commodities futures accounts, including cash in a commodities futures account, are generally not protected by SIPC. Similarly, gold and silver coins are not considered to be a security and thus are not protected by SIPC. As the definition of what is – and is not – a security protected by SIPC can be complex, professional guidance is recommended.

- **Multiple accounts:** SIPC account protection is offered on a "separate capacity" basis. Whether or not one account is "separate" from another, and thus benefits from the full $500,000/$250,000 SIPC per-account protection, depends on different ownership. For example, an individual account owned by Mary is separate from the joint account Mary owns with her husband Joe. However, because of the complexities which can occur in securities accounts, professional guidance in this area is strongly suggested.

For Further Information

For additional information concerning the protection provided to investors by SIPC, see your individual broker or visit the SIPC website at http://www.sipc.org/. By telephone, SIPC can be reached at (202) 237-8300.