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If a Brokerage Firm Closes Its Doors

Given the turbulence affecting the financial services industry these days, you may be wondering what would happen to your securities account if your brokerage firm closed its doors.

In virtually all cases, when a brokerage firm ceases to operate, customer assets are safe and typically are transferred in an orderly fashion to another registered brokerage firm. Multiple layers of protection safeguard investor assets. For example, registered brokerage firms must keep their customers' securities and cash segregated from their own so that, even if a firm fails, its customers' assets will be safe. Brokerage firms are also required to meet minimum net capital requirements to reduce the likelihood of insolvency, and to be members of the Securities Investor Protection Corp (SIPC), which insures customer securities accounts up to $500,000. SIPC insurance comes into play in those rare cases of firm failure where customer assets are missing because of theft or fraud. In other words, SIPC insurance is used as a last course of action in the unlikely event that the other customer protections have failed.

This publication explains the role regulators—including FINRA—play when a firm goes out of business unexpectedly, and what you should know and do in the event that your brokerage firm ceases to operate. While the customer safeguards are extensive and the track record of making investors whole in the aftermath of a financial crisis is strong, not all investor assets may be covered, and there are steps and precautions investors can take to help protect their assets-not to mention their peace of mind.

Updated Information for Former Customers of Lehman Brothers, Inc.

On December 2, 2008, SIPC announced that an estimated 925,000 claims forms were mailed to customers and creditors of Lehman Brothers Inc. (LBI). View more information.

Regulatory Safety Net

Brokerage firms are required to follow certain rules that are designed to minimize the chances of financial failure and, more importantly, to protect customer assets if they do fail. For example, the SEC's Rule 15c3-1—the "Net Capital Rule"—requires brokerage firms to maintain certain levels of their own liquid assets. The minimum net capital a firm must have on hand depends on its size and business.

In addition, the SEC's Rule 15c3-3—the "Customer Protection Rule"—requires brokerage firms that have custody of customer assets to keep those assets separate from their own accounts. In other words, customers' cash must be placed in a special, separate "reserve" account; and fully paid customer securities must be kept separate from firm and customer margin securities.

Carrying and Introducing Firms

To understand how these rules work, it is helpful to understand the difference between "clearing and carrying" firms (or "carrying" firms for short) and "introducing" firms. When you open an account with a brokerage firm that is a carrying firm, the firm not only handles your orders to buy and sell securities, but it also maintains custody of your securities and other assets (like any cash in your account). With an introducing firm, the brokerage firm accepts your orders—but it will have an arrangement with a carrying firm to maintain custody of your securities account. Because they have custody of customer assets, carrying firms must maintain higher levels of net capital than introducing firms—and they are responsible for segregating the customer funds and securities in their custody.

Additional rules require firms that do business with public customers to have their financial statements audited by an independent accounting firm annually. All brokerage firms must file financial statements (on Form X-17A-5) with the SEC—and those that are publicly traded must file quarterly, annual and other periodic reports with the SEC (which investors can view using the SEC's EDGAR database of company filings). We describe how an investor can obtain a firm's financial statements in our Investor Checklist.