EXECUTIVE RISKS PRACTICE

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BEYOND SIPC

ISSUE

Soon after the financial collapse exposed the schemes of Bernard Madoff and other dishonest broker dealers, the losses those schemes generated raised the question of insurance coverage. Many eyes turned to the Security Investor Protection Corporation (SIPC). The limitations of that protection led investors to look beyond SIPC to see what other coverage might be in place.

IMPACT

SIPC offers insurance coverage to customers of member securities broker dealers for the theft or loss of securities or cash in their accounts. The coverage, however, is limited to $500,000 in securities and $100,000 in cash for each customer. While this is adequate protection for the average investor, it affords little meaningful coverage for institutional investors or high-net-worth individuals.

Most national and regional broker dealers – but not all – buy additional coverage. Lloyd's of London and other London insurance markets write an Excess Customer Protection policy that sits excess over the $500,000 of coverage provided by SIPC. The policy requires that SIPC first make payments to customers, in essence using SIPC as the basis for determining whether claims are valid.

The London programs apply an aggregate limit of liability, unlike the SIPC protection, under which the full $500,000 per-customer limit applies to all customer accounts regardless of their number. Typical excess limits vary from as little as $100 million of aggregate protection (with a per-customer limit of $5 million) to an aggregate policy limit of $1 billion (with per-customer limits of up to $150 million for securities coverage per customer and $1,900,000 in cash coverage). Some large firms pay an additional premium to eliminate the per-customer limit entirely.

SIPC does not cover market loss or stock fraud. If stocks lose their value, the broker – and the SIPC – are not on the hook. SIPC will only become involved when a brokerage firm actually fails. Many of the parties directly involved with the failed firm – the primary owners, executives or others with controlling interests – will not be eligible for SIPC coverage for losses related to the firm.

ACTION

If they have not done so already, broker dealers should consider Excess SIPC protection. But simply maintaining this coverage may not be enough, as the extent of their per-customer limits and overall aggregate limits could prove to be a key differentiator between them and their competition.

Institutional clients and high-net-worth individuals should confirm with any broker dealer they utilize whether the firm has any additional coverage should a catastrophic loss occur. They should also know the limits available under that coverage. The additional protection available to large investors should be an important consideration when selecting a broker dealer.

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