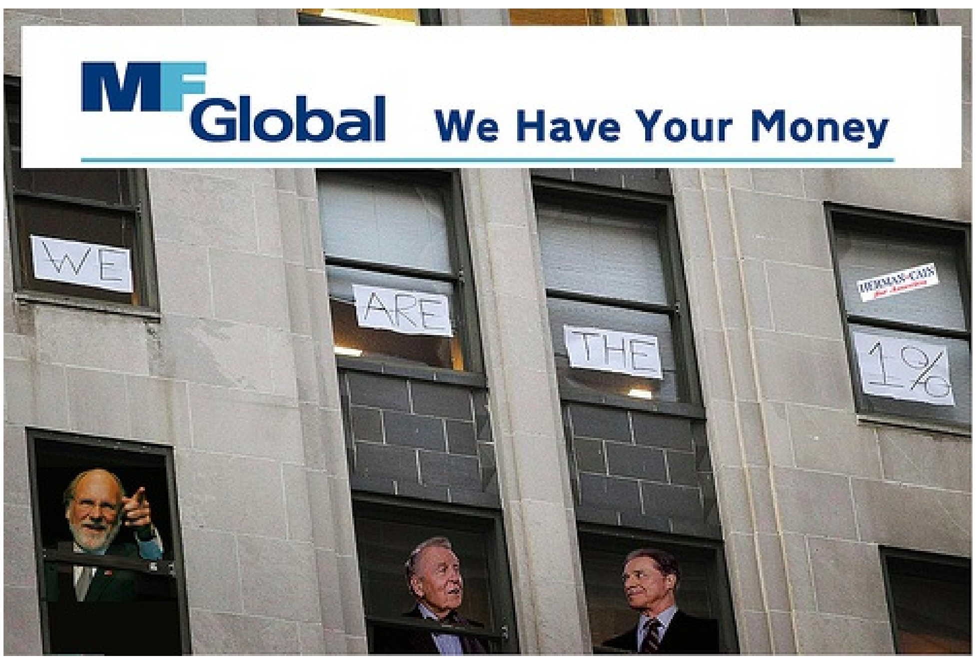
Special Report

Gold Stock Bull Guide to

Protecting Your Stocks from Brokerage Bankruptcy & Theft



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How to Reduce Risk to Your Online Brokerage Account

The prior head of MFGlobal, Jon Corzine, told Congress that he simply did not know what happened to over $1 Billion in client funds. Many customers lost 40% or more of the funds they had invested with the bankrupt firm, while insiders took their 100% and ran before anyone knew what was happening. Gerald Celente, founder at Trends Research Institute, lost six figures on his gold futures held with MFGlobal, which he talks about in this video.

There are growing concerns amongst investors that the same type of theft or bankruptcy could happen at any major online stock brokerage such as E*Trade, TDAmeritrade, ScottTrade, etc. Investors with the bulk of their wealth tied up in these brokers might want to consider some common sense steps for protecting their shares.

Many believe they will be protected by the Securities Investor Protection Corporation (SIPC), which insures accounts up to $500k for securities, and account cash balances up to $250k. Of course, this does not provide comprehensive protection if you have account balances higher than these amounts.

But the bigger red flag is the fact that the SIPC does not have sufficient funds to backstop the failure of a single major brokerage house, let alone several collapsing at one time. The SIPC balance is thought to be around $1 Billion, which would only cover a fraction of total customer accounts if just a few brokers were to go under.

To put this amount into perspective, consider that the Federal Savings & Loan Insurance Corporation (FSLIC) had $5.6 billion on hand in 1984 to pay claims. By 1989 that had turned into an $87 billion deficit due to the S&L crisis. In 2006, the GAO put the total resolution cost of the S&L bailout at $166 billion!

Put another way, if just 2,000 customers had to be paid out $500k each, the SIPC funds would be depleted. Now consider that TDAmeritrade alone has over 6 million U.S. customers and you start to get the picture.

If you have faith in the government to bail you out in the event that the SIPC can not, remember that the SIPC is ***not*** guaranteed by the US government so there is no guarantee of a bailout if it goes insolvent like the FSLIC did in the 1980's. Furthermore, you would be relying on a bankrupt government to bailout a bankrupt SIPC, that is attempting to bailout a bankrupt brokerage firm. And even if a bailout were to occur, it would happen with inflated dollars that are likely to be worth much less by the time you receive them.

Street Name Registration

When you buy stocks from your online broker, the stocks usually aren't issued in your name but they are put in "street name" meaning the broker's name. The is the traditional form of share ownership and well over 90% of investors use this method for the convenience it offers. A company issues shares to a transfer agent, who then gives the shares to the broker, who holds the shares on your behalf. The broker will keep records showing you as the "beneficial" owner, but you will not be listed directly on the issuer's books. Instead, your brokerage firm (or some other nominee) will appear as the owner on the issuer's books.

The benefit of this method of ownership is convenience, low cost and speed of transactions. You can sell your shares instantly and you don't incur additional administrative fees.

The obvious problem with this method is that the shares are not in your name, even though you have paid for them. If the broker goes bankrupt, you may very well lose your shares. If a broker runs into liquidity issues, like MFGlobal, they may need to use your shares as collateral or for other purposes to prove solvency. Feel secure?

The other problem with leaving your shares in street name is that when another one of the broker's customers wants to short the same stocks that you "own," the broker lends them your stocks to sell short (without your knowledge). Not only is the broker profiting off your shares, but others are using your shares to bet against your long position.

So, if you are ready to reduce your risk and get your shares out of “street name” and into your name, there are two methods for accomplishing this:

Method #1 for Reducing Risk: Direct Registration

The DRS (direct registration system) provides for electronic direct registration of securities in *your* name on the books of the transfer agent or issuer, and allows shares to be transferred between a transfer agent and broker electronically. You don't have to worry about taking delivery and safekeeping the share certificates. While you will not receive a certificate, you will receive a statement of ownership and periodic account statements, dividends, annual reports, proxies, and other mailings directly from the issuer.

This method pretty much eliminates any risk of theft or bankruptcy on the part of your broker or clearing facility. Your shares also can NOT be lent out by your broker to short sellers or used as the broker's collateral.

But the downside is that the shares are still not in your possession and are subject to risk of fraud on the part of the transfer agent. The other negative is that while you can trade shares faster than if you took possession, you can't trade immediately like when your shares were in street name. It can take a few days to sell shares.

As all companies, brokers, and transfer agents have different rules, you must call to find out if the shares are eligible for direct registration. Call your broker to determine if you can change your method of ownership to direct registration and what fees are involved. You will also need to contact the transfer agent to confirm the eligibility and set up an account that proves the ownership in your name.

Also, remember that the online brokerages make money from keeping your shares in street name, so they may be reluctant to assist you or they may give you misleading information. Remain calm and persistent and if necessary, change brokers.

Method #2: Take Possession of Physical Share Certificates

The absolute safest way to reduce your risk is to request that actual stock certificates be delivered to you. You will have zero counter-party risk from your broker, clearing house or transfer agent. The shares can not be seized electronically or turn up missing in the event of any electro-magnetic phenomenon. This is similar to taking possession of precious metals (and for the same reason).

While you will be charged a fee and not be able to trade shares instantly, the reduced risk should compensate for these burdens, particularly for long term investors. If and when you decide to sell, you simply sign the certificates and mail them back to your broker. If the financial system were to collapse, you would still be holding shares that legally give you ownership of a percentage of a real company with real assets.

In order to take physical delivery of your shares, you will need to call the company, determine which transfer agent they use and confirm that they allow for delivery of paper shares. Then call your broker and tell them you want to take physical delivery of your shares. Your broker will digitally transfer the shares to the transfer agent and they will then print and send the share certificates to you.

The biggest risk with taking possession of your shares if loss via theft or fire. I personally use a fire/burglary safe for protection of my share certificates, along with other property. You can learn more about how to choose and purchase a safe by downloading the Gold Stock Bull Guide to Buying a Safe, which is free to all GSB premium members.

If your shares are lost or stolen, you can usually request new copies, but it is a burdensome and expensive process. Call your transfer agent immediately so that they can put a stop on the shares. They will then begin the process of issuing new shares, but with all fees included it could end up costing you as much as 4% of the value of the shares. If you lose $100,000 worth of shares, be ready to fork over up to $4,000 to get new certificates. This further justifies the purchase of a quality fire/burglary safe and you may also want to consider an insurance policy that covers you in the event that your shares are lost or stolen.

IRA or 401k Accounts: Some people are opting to take the penalty and tax hit to cash in IRAs and get their money out safely. If you decide to stay with an IRA, many "self-directed" IRAs will allow for direct registration or share delivery.

It can be more difficult with IRA accounts, so call your plan administrator and research a few self-directed IRAs to learn more. If you don't want to leave your shares in street name, you will either have to switch to an IRA that allows for direct registration or cash out early. Please remember that I am not an investment or tax advisor, so you should speak with one before doing anything.

Bonus Method: Remove Excess Cash from Brokerage Account

Any cash that you have in your brokerage account is usually swept into an FDIC insured account, but this is not always the case. Increasingly, institutions are offering consumers a broad array of investment products that are not deposits and not insured by the FDIC. So, make sure that you understand how your broker is holding your cash and that it is secure.

However, I believe an even better idea is to simply perform a free online electronic ACH transfer from your broker to your bank/credit union of any excess cash in your account. If you later decide to make purchases, it is a simple matter to transfer the necessary cash back to your brokerage account electronically. In the meantime, your funds may be better-protected within your local community bank or credit union and you will have faster access to the funds if a quick withdrawal ever becomes necessary.

I believe that local, non-profit, member-owned credit unions are vastly superior and safer than large banks. They are less likely to have exposure to toxic derivatives or utilize customer funds on risky leveraged gambles. Check out the Move Your Money campaign to learn more and locate a trustworthy credit union or community bank in your area.

Summary

In today's turbulent times, it is becoming increasingly important to understand your investment risks and reduce or eliminate them whenever possible. While the direct registration or physical possession methods listed above come with some disadvantages in terms of cost and convenience, they can help to safeguard your stock wealth and may end up saving your tens or hundreds of thousands of dollars.

I think a good approach is to utilize one of these two methods for longer-term core holdings and leave short-term trading positions in street name. This will provide some protection, while keeping your costs reasonable and allowing you to continue to take advantage of short-term trading opportunities.

If you also leave as little excess cash as possible in your brokerage account, your broker does not have access to either your stocks or the cash in your account. This should reduce your risk going forward and provide for some peace of mind.

As a final note, I personally would never keep more than 50% of my liquid wealth with any bank or brokerage in electronic form. I believe it is critical to have a good amount of physical metal and cash outside of the banking system. Whether you choose to use a private vault storage company, install a safe at home or hide your bullion and cash, I think it is wise not to have all of your proverbial eggs in one basket.

Cheers,

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