Is It Safe to Invest at Just One Brokerage?

The answer, most financial advisers say, is yes. But there are no guarantees.

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There's a lot to be said for consolidating investment accounts under a single brokerage roof: It allows for easy management and maybe more attention or discounts from the firm.

But financial advisers say some people to whom they suggest the move are leery. "Some investors will say they want to spread their money between several brokers, that they don't want to put all of their eggs in one basket," says Frank Boucher, a certified financial planner in Reston, Va.

Concerns about sticky-finger brokers or a firm going under are understandable, with memories still fresh of Bernard Madoff's more than $60 billion Ponzi scheme and the collapse of commodities brokerage MF Global Inc. Still, advisers and other financial specialists say there are numerous protections in place for investors.

Layers of Protection

For starters, mutual funds and exchange-traded funds have some built-in safeguards. They are required to place their assets with third-party custodians for safekeeping, and regulations require the custodians to segregate the funds' assets from other assets held by the custodian.

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The Securities Investor Protection Corp., headed by Stephen Harbeck, can step in when a brokerage fails. Bloomberg News

So, while a fund may be in the name of Vanguard Group or T. Rowe Price Group Inc., for instance, the underlying securities are held by a custodian to protect the fund investor. Vanguard uses firms including J.P. Morgan Chase & Co., State Street Corp. and Bank of New York Mellon Corp.

Further, "the fund and the fund service company are separate legal entities, and the fund's assets aren't available to the creditors of the service provider," in the event that the provider goes under, says Vanguard principal Barry Mendelson.

At the securities-firm level, one fairly common misconception is that the investment firm itself has some claim on the investors' assets, when in fact assets in client accounts strictly belong to the clients and legally must be kept separate from the company's own assets.

Another layer of protection is the Securities Investor Protection Corp., a nonprofit, nongovernment corporation funded by member securities firms. SIPC acts as protection for investors if the brokerage firm holding the investors' assets fails and there are cash and securities missing from customer accounts.

Generally speaking, stocks, bonds, mutual funds and other registered securities are covered, while unregistered limited partnerships, foreign currency, fixed annuity contracts, and commodity options and futures contracts aren't covered. (SIPC doesn't protect investors from declines in the market value of their securities, even in cases where the decline in price is the result of fraud, notes SIPC President and Chief Executive Officer Stephen Harbeck.)

And there is a limit to how much SIPC will cover—the corporation will reimburse investors up to $500,000 per account holder per account type, with coverage of cash limited to $250,000 per account. (Protection is in addition to any prorated share of assets investors may receive from the failed firm, if that share is insufficient to cover the loss.)

Many brokerage firms also provide additional protection beyond SIPC's limits through private carriers—typically called "excess SIPC" coverage. Maximum amounts vary by firm.

Payment isn't instantaneous. If the debtor firm's records are accurate and another brokerage firm is willing and able to accept an account transfer, a trustee may be able to transfer assets, supplemented with SIPC funds as necessary, in a week to 10 days. If there are complications, the process can take months.

Madoff and MF Global

Madoff clients with under $875,000 have already been paid in full, says Mr. Harbeck. Those with multimillion-dollar claims have received 43% of their claim back plus the additional $500,000 from SIPC, Mr. Harbeck says, and will share in any additional assets recovered by the trustee and his counsel.

Not including the continuing Madoff case, from 1970 through 2012, only 351 people haven't received the full amount of their assets left with a collapsed SIPC-member firm, according to SIPC. That's because the investors' claims in those 351 cases exceeded the SIPC maximums and the amount of available customer property.

Still, says Mr. Harbeck: "You can't say there's absolutely no risk. You just can't."

MF Global, meanwhile, had both commodities and securities customers. The securities customers were virtually made whole within a few months, said a representative for the court-appointed trustee. The commodities customers trading on U.S. exchanges, however, don't fall under SIPC, but have received 98% of their claims so far.

Overcoming Anxiety

While there's no way to completely remove institutional risk from the equation, many advisers say that the benefits that come from account consolidation in many cases should outweigh fears of broker malfeasance.

Washington Wealth Management Chief Executive Rob Bartenstein, in San Diego, says he doesn't typically recommend that the average investor split assets in order to hedge institutional risk, noting that modern history "demonstrates that the risk of loss is relatively low in these scenarios due to regulatory oversight and intervention, adequate insurance and other backstops."

Michele Royalty, 66, of Mammoth Lakes, Calif., a recent retiree from the pharmaceutical industry, says she had some initial apprehensions about consolidating all of her investments. Still, Ms. Royalty—an active do-it-yourself investor—says she decided to move all of her accounts to Fidelity Investments, primarily because the ease of management outweighed her concerns. "My setup is a lot simpler," she says, adding that it will also be much easier for her heirs to manage.

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