

# Client Alert

A report  
for clients  
and friends  
of the Firm     April 2008

## Follow-up FAQs Regarding Customer Asset Protection in a Broker-Dealer Bankruptcy

We received a number of inquiries in response to our recent FAQs on broker-dealer bankruptcies. Answers to some of the more frequently asked questions appear below.

### **If securities are held in a margin account but there is no margin loan outstanding at the time a broker-dealer fails, how are the securities in that account treated?**

Securities held in a margin account where no margin is extended are fully paid securities. Under the customer protection rule, a broker-dealer is required to maintain fully paid securities in its possession or control. Thus, absent fraud, these securities would be distributed ratably to the account holder as a return of customer property.

### **Would those securities held in the margin account be transferred to another broker-dealer “free and clear”?**

Yes, assuming the SIPC trustee is able to transfer customer accounts from the failed firm to another SIPC member firm, the securities would be transferred to a margin account at the new broker-dealer where they would be held as fully paid securities of the customer, free and clear of any claims, liens or encumbrances against the failed broker-dealer.

### **What happens to securities held in a margin account if margin credit is extended at the time the broker-dealer fails?**

Generally, under a margin agreement securities held in a margin account (except for excess margin securities) provide the collateral for margin debt. A margin agreement also will permit the brokerage firm to lend securities (other than excess margin securities) in the margin account to another broker-dealer or bank. If your securities have been loaned, the SIPC trustee will recall them and they will be available to be distributed to you as customer property upon repayment of the debit balance in the margin account. Excess margin securities (securities with a value in excess of 140% of the outstanding customer debt) are fully paid and are distributed as customer property.

### **What does securities “held in customer name” mean?**

Many people hear the term security and imagine a paper stock certificate. Today most securities are in electronic form and held in “street name” (the name of the broker-dealer or a custodian) so they can be transferred within the Depository Trust & Clearing Corporation (DTCC), which maintains custody of securities. Customer name securities are limited to those securities in certificated form in connection with which no stock power has been executed (so that the certificate is not transferable to or by the broker-dealer). In today’s market environment it is highly unusual for customer name securities to be held by a broker-dealer.

In those rare instances where securities are held in customer name by a failed brokerage firm, those certificates will be returned to the owner on a priority basis. All other securities of the failed broker-dealer’s customers will be distributed ratably based on customers’ net equity claims.

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