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Is Cash You Keep at Your Brokerage Safe?

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Do you know where the cash in your brokerage account goes each night? If not, start asking.

Every brokerage firm offers some sort of cash-management account, or CMA, which generally allows you to trade securities, write checks, and use a credit or debit card -- all via a single account. Minimum balances can be high, running well into the thousands of dollars, but many investors find the convenience of combining several types of account features in one place worth it. A CMA is also typically the default destination for dividend payments and the proceeds from securities sales.

To provide a modest return on funds you don't need immediately, any cash left over in a CMA is automatically 'swept,' or transferred, overnight into another account that pays interest. This is where you need to pay close attention. Some brokerages sweep into traditional bank-deposit accounts, which are federally insured up to certain limits . But others sweep into money-market mutual funds, which may or may not be insured, and even then are insured temporarily and only for funds already in accounts as of Sept. 19. (See chart below.)

Let's say, for example, you had a CMA with Ameriprise Financial (AMP). It's possible some of your cash was swept into the Reserve Primary fund, a money-market mutual fund that rattled investors when it 'broke the buck' three months ago. The result? A potential loss of three cents on the dollar and uncertain access to cash you thought was available on demand. Ameriprise is now suing The Reserve and putting up its own money to cover clients' losses.

Also, some brokerages sweep into their own interest-bearing accounts that have no federal insurance at all. For instance, at Fidelity, cash that clients plan to reinvest in the near term -- including proceeds from the sale of securities -- are by default swept into what the company calls 'FCASH' accounts. These accounts only have some protections via the Securities Investor Protection Corp., which tries to recover assets when brokerages fail.

In theory, all this was explained to you when you opened your account, and you can find details in the fine print of your brokerage agreement. You might have even been offered various sweep options. But in reality many investors don't have a full grasp on where their cash ends up each night.

'With any brokerage firm you have to pay attention to what the sweep is going into,' says Bill Walsh, president of money-management firm Hennion & Walsh Asset Management.

On the bright side, to date just about every major mutual fund company with money-market funds has signed up for the Treasury Department's temporary insurance program and has signed up for the extended guarantee through April 2009. And low returns notwithstanding -- yields on money-market mutual funds have tumbled below 1% -- total assets in money-market funds are at a hefty $3.78 trillion, according to the Investment Company Institute.

But keep in mind the Treasury's insurance program is completely voluntary. Mutual fund providers must choose to sign up and pay a fee; brokerages and individual investors can't request the insurance themselves. So if your brokerage CMA sweeps into a money-market mutual fund, find out who the underlying fund company is and whether they've sign on for the extended Treasury insurance. The deadline for funds to re-enroll was Dec. 5; otherwise the insurance expired on Thursday, Dec. 18.

Does all this mean you should dump your CMA? Not necessarily. If you're planning to reinvest the cash in the near future, these types of accounts still make sense. The key is understanding where your cash goes and what, if any, protections are available in worst-case scenarios. If you're not looking to reinvest the cash soon and are more interested in earning a better yield, you might check into money-market deposit accounts at commercial banks instead. They're liquid, transparent and above all FDIC-insured.