By Eric Miller

Is Your Money Safe?

Economic events such as the Financial Crisis in 2007-08 was definitely a wake-up call for many. The 2008 crash was the first time since the Great Depression that many people witnessed what could happen to major financial institutions in a matter of days. Lehman Brothers—gone, Bear Sterns—gone, Washington Mutual Bank—gone. And if it weren't for the backing of the American tax payers, AIG, Freddie and Fannie Mac, Bank of America, and a whole list of others would have tanked as well.

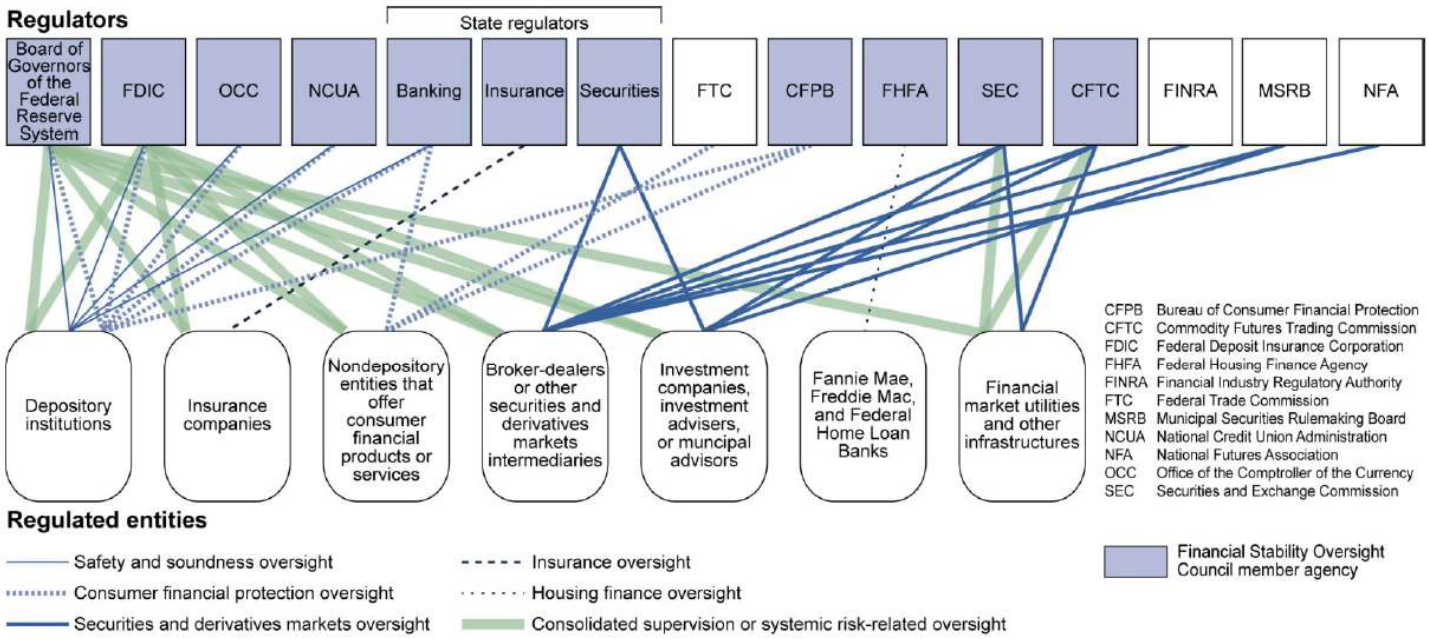
Our banking system and financial regulatory system are not stable. To illustrate this fact, I've included the chart below which was taken from a Congressional Research Service to show just how convoluted and disorganized our major financial institutions have become.

Imagine if this was your practice's organizational chart. Your employees and customers would have no idea who to follow, listen to, or go to for guidance. Yet this is the structure in which trillions of dollars of citizens' money is being held and the agencies that regulate the various parts of it. If you had any suspicion and anxiety about the safety of your money, this is proof that it is warranted. Unfortunately, the financial institutions you have been told are "safe" are actually an illusion of worthless promises, over-leverage, over-speculation, and susceptible to being torn down by the winds of mischance—and the worst part is your wealth is at risk.

So what do you do? Of course I'm not telling you to take all of your money out of the bank and bury it under your mattress. My main objective is for you to simply be AWARE of where your money is held and understand how that financial institution operates so you understand the actual risk (not the apparent risk).

Below is a general overview of the three types of financial institutions (generally): 1. Depository Institutions, 2. Investment and Securities Institutions, 3. Contractual Institutions. Here's what is included in

Figure 1. Regulatory Jurisdiction by Agency and Type of Regulation



Source: Government Accountability Office (GAO), *Financial Regulation*, GAO-16-175, February 2016, Figure 2.

my analysis of these institutions, but I'm sure there will be some exceptions to these characteristics.

- The type of financial institution
- The type of financial activity they engage in
- The amount of leverage they utilize
- The regulatory body which oversees them (good luck figuring this one out)
- Their solvency risk
- How much risk these institutions are subject to from a seismic financial event

Here we go:

1. Depository Institutions

This type of entity is designed to legally accept and safeguard monetary deposits from the public. They act as a conduit for individuals and organizations to hold their money between whatever transactions their customers engage in. They have the ability to lend those deposits to individual and corporate buyers to spur economic activity.

Examples of this type of institutions include Commercial Banks, Saving and Loans, and Credit Unions. Each of these institutions is established by a Charter. That means that in order to legally operate they must abide by the rules of the regulatory body which oversees them. Most of these organizations have both state and federal oversight. The main federal bodies which oversee these types of institutions are The Board of Governors of the Federal Reserve, the FDIC, The Office of the Comptroller of the Currency (OCC), The National Credit Union Administration (NCUA), and The Bureau of Consumer Financial Protection (CFPB).

These organizations are in the business of lending. Therefore they are subject to many risks. The predominant risks are as follows:

1. System failure risk: The worldwide banking network is completely interconnected. What happens overseas can have an effect on the member banks of this country.

2. Interest rate risk: The "price" of loans or its interest rates can fluctuate, which can certainly have a negative impact on a bank's balance sheet.

3. Credit or default risk: Let's face it, if these lenders lend too much money to people who cannot pay back the loans, it can cause a massive amount of instability for these institutions.

4. Fraud or operational risk: Cyber-attacks are now becoming a main source of loss for financial institutions. It doesn't take much for hackers to get access to millions of accounts and cause unlimited havoc.

My 2 cents: Banks are promoted as "safe" financial institutions with "safe" financial instruments for you to position your money. From 2008 to 2012 there were 465 banks which failed according to the FDIC records. Compare that number with the other types of financial institutions and you can see that banks should simply be utilized to store a small amount of liquidity and should not be considered as a "safe haven" for your investments.

2. Investment and Securities Institutions

These are entities which are primarily in the business of securities trading and providing investment and wealth management services to the public at large. These include brokerage firms and investment companies.

Brokerage firms: These are companies which are in the business of connecting buyers and sellers of securities. There are full service and discount brokerage firms and they offer a vast array of services, however they mainly operate on trading and creating commissions. TD Ameritrade, E-Trade, Schwab, Fidelity, and Merrill Lynch are examples of brokerage firms.

Investment companies: These are companies which will pool investor money together and invest it based upon a particular strategy. The most popular example of an investment company would be a mutual fund company such as Vanguard or

Fidelity Mutual Funds.

Most brokerage and investment institutions are regulated by the Securities and Exchange Commission (SEC). There are other companies which are considered self-regulating bodies which are formed to assist in making sure there is sufficient oversight. FINRA (Financial Industry Regulatory Authority) is a body which will write and enforce rules for brokers and dealers to ensure compliance.

While these types of institutions are, by and large, safer than banks in terms of company failure, that doesn't mean they are riskless. Bad management can cause any brokerage or investment firm to go belly-up. In addition, the sheer number of brokerage and investment companies makes it almost impossible for the SEC to be able to oversee all these types of companies.

There is a type of investor "insurance" if a brokerage firm goes bust. It is called SIPC (Securities Investor Protection Corporation). If you have an account with a brokerage firm that goes insolvent, then this MAY help remedy some of your account if the firm gets liquidated. There are limits to the protection ($500,000 and $250,000 for cash) and it only applies to the CUSTODY function of the brokerage firm—NOT the investments. If you were sold a bunch of bad investments and they are now worthless, the SIPC won't cover it. If you owned a stock for 30 years and the company (not the brokerage firm) went belly-up—sorry about your luck. The SIPC won't cover it. FDIC and SIPC are two totally different protections, you must know them or you will think you are protected when you are not.

My 2 cents: I'm sure many of you reading this have your retirement accounts positioned in these types of financial companies. While I have more faith in these companies staying solvent on a company level, I have concerns that a majority of business owners have too much of their reserves and retirement savings held at these institutions without fully understanding that an account can massively go down in value due to the performance of the underlying securities.

3. Contractual Institutions

These are institutions which will acquire money on a contractual basis. In other words, there is a legal agreement which binds the two parties involved. The contractual institution will invest the money in such a way that they can meet whatever obligation they are required to, based upon the contract. Examples of these entities would be life insurance companies, fire and casualty insurance, and state and government pension plans.

Life insurance companies have been in existence in some form since ancient Rome, but most recently in the early 18th century. They create products which will provide death benefits for families through life insurance contracts or guaranteed income for life through annuity contracts. Unlike banks, life insurance companies are not allowed to extend loans that are not backed by actual reserves. Life insurers are not regulated by the federal government, they are run by each state. There is a National Association of Insurance Commissioners (NAIC) who does set standards and regulations which are adopted by the states. Each state also has a state guaranty fund designed to make whole policy holders who are part of an insurer who is going insolvent. The limits are generally $250-300k. The NAIC does not allow insurers to market this state guaranty fund so it remains largely unknown to most policyholders.

In addition, insurance companies must keep a hefty amount of statutory reserves in cash to be able to pay for certain obligations. This doesn't allow them to maximize the yield on the cash, but it does mean during times of distress, life insurance companies have historically been very sound.

My 2 cents: In the battle of which institution will provide the most stability, I would say that the contractual institutions win—hands down! Simply due to the fact that they do not operate on huge amounts of leverage (like banks) and the security that the money inside of these policies is generally invested very conservatively to minimize loss of

value (unlike investment and brokerage firms). They have enormous reserves and have historically not had near the rate of insolvency failure as banks have experienced over the decades of their existence.

Summary

Navigating the financial landscape can be a daunting task. Especially when there are complexities in understanding where your money is safest. We often don't examine this topic until an economic crisis threatens our survival (about every 10 years or so). The team here at Econologics Financial Advisors uniquely focuses solely on guiding private practice owners along their path to financial success. We understand the unique challenges of practice ownership and we advise our clients on a multitude of areas such as tax minimization strategies, debt reduction, retirement and exit planning, practice expansion planning, asset protection, wealth management and so much more.

With the Econologics® Results-Based Financial Planning® System, all of that uncertainty goes away. You'll have a map to know exactly where you are going and how to get there, while objectively measuring your progress along the way to avoid financial pitfalls and mistakes and feel fully in control of your financial future.

EVERY practice owner needs a financial advisor who understands how important their business is to their household, stands by them when times get tough, holds them accountable, and guides them through times like the current. This isn't a journey you should travel alone. It is important to lean on us as your guide.

Get guidance and a plan built specifically for your needs so you can enjoy every phase of ownership while reaching your personal financial goals along the way. Visit our website at **www.EconologicsFinancialAdvisors.com** and download a free guide or financial checklist or call our office and speak to an Econologics Specialist at 727-588-1540 for more info.

Eric S. Miller is a 20+ year veteran of the financial planning profession. He is a co-owner of Econologics Financial Advisors® and a registered series 6 and 65 financial advisor as well as insurance licensure nationwide. Having had over 10,000 conversations with private practice owners discussing financial matters of their household and business, Eric has guided his clients into a more optimum financial condition using a proven system that gets results.