

# How Low Can You Go: Despite Historically High Interest Rate Period, Brokerage Firms Keep Sweep Rates Down

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and Emer Burke



At any given time in the United States, trillions of dollars of customer cash sits uninvested in brokerage accounts.<sup>1</sup> Because broker-dealers are restricted by regulation from using customer cash for their businesses,<sup>2</sup> they transfer or “sweep” the cash, usually either to FDIC-insured bank accounts or government money market funds, which earn interest for those customers. To maximize profits, however, many brokerages sweep to affiliated banks paying extremely low interest rates. Sweep accounts effectively become interest-free loans from customers to large financial institutions, who then use the cash to lend or invest at higher rates, which generate interest rate “spreads.” Recent lawsuits and regulatory investigations have highlighted the danger arising from this form of self-dealing: sweep rates are often hundreds of times lower than similar cash preservation products and the federal funds overnight rate at which banks invest cash with the Federal Reserve.

Brokerages that sweep cash to affiliated banks often pay the lowest interest rates possible. For example, Merrill Lynch Pierce, Fenner & Smith, Inc. sweeps cash to its affiliate, Bank of America, N.A., and currently pays many of its brokerage customers sweep rates of 0.01% APY.<sup>3</sup> E\*TRADE Securities LLC also sweeps to its affiliate at Morgan Stanley and pays many of its brokerage customers 0.01% APY.<sup>4</sup> Other examples include Schwab (0.45% APY), UBS (0.05% APY), Wells Fargo (0.05% APY), and Ameriprise (0.30% APY). In contrast, brokerages that sweep to unaffiliated

<sup>1</sup> Financial Planning, April 25, 2023, “Cash sweeps: a \$1T conflict of interest in wealth management” (<https://perma.cc/T5K2-LGNQ>).

<sup>2</sup> 17 C.F.R. § 240.15c3-3.

<sup>3</sup> Merrill “Yields at a Glance Cash Management Solutions” dated August 12, 2024 (<https://perma.cc/SJ92-C97X>).

<sup>4</sup> E\*TRADE “Rate Monitor” dated August 13, 2024 (<https://perma.cc/W436-TLU4>).



banks, and which do not labor under the same conflicts of interest, frequently offer more competitive rates, with Fidelity Investments paying 2.72% APY<sup>5</sup> and R.W. Baird paying 1.96% to 3.98% APY, depending on asset tier.<sup>6</sup> Vanguard Investments and Fidelity Investments pay even higher rates when sweeping to government money market funds (VMFXX (5.29%) and SPAXX, (4.99%), respectively).

Cash sweeps represent a “transfer of wealth from customer to brokerage firm” and “it is in the billions of dollars,” Robert Finkel, a senior partner at Wolf Popper LLP, told the *Financial Times*.<sup>7</sup> In August 2019, Wolf Popper initiated a class action lawsuit against Merrill, alleging that it breached its Client Relationship Agreement, which states that “[t]he interest paid on retirement account assets will be at no less than a reasonable rate.”<sup>8</sup> The U.S. District Court thereafter sustained the plaintiff’s breach of contract claim arising from this provision.<sup>9</sup> This contractual term, which exists in other customer agreements from prominent brokerage companies, is no accident: the sweeping of retirement customer cash to an affiliate is, given the obvious conflict, a “prohibited transaction” under Section 4975(d)(4) of the Internal Revenue Code and Section 408(b)(1) of ERISA, unless interest rates are “reasonable.” In May 2024, Merrill unilaterally amended its agreement to remove the provision in an attempt to deprive customers of their contractual right to reasonable interest rates on their cash.<sup>10</sup>

The initial Merrill lawsuit, covering the period December 2016 through March 2020, alleges that Merrill paid just 0.14% APY on swept cash, even as the effective federal funds rate exceeded 2.4%. In a subsequent lawsuit, a different retirement customer, again represented by Wolf Popper, alleges that starting in March 2022 (when the federal funds rate and market rates increased sharply following the Covid-19 pandemic), Merrill paid even less defensible interest rates.<sup>11</sup> The complaint highlights that Merrill’s rates for tier 1 and 2 retirement account customers—those with less than \$1 million in assets under management—remained at a mere 0.01% APY, roughly 500 times lower than contemporaneous rates on similar products. The lawsuit seeks damages arising from the underpayment of interest and an injunction to prevent the continuation of these practices. As Finkel was quoted in *The Wealth Advisor*: “The rates have stayed so low compared with market rates, which tend to be high.... The delta between the two just suggests that there is something inappropriate with how low the sweep rates have stayed.”<sup>12</sup>

5 Fidelity “Cash Management Account” dated August 12, 2024 (<https://perma.cc/47FP-N53V>).

6 Baird “Cash Sweep Program” dated August 12, 2024 (<https://perma.cc/M5UH-5E8R>).

7 Financial Times, August 6, 2024, “SEC investigating Wall Street banks over ‘billions’ in lost interest payments” (<https://www.ft.com/content/de751907-c870-4b8c-b86b-317483f7626f>).

8 Merrill Edge Self-Directed Investing Client Relationship Agreement dated November 2023 (<https://perma.cc/2NT7-698H>).

9 Valelly v. Merrill Lynch, Pierce, Fenner & Smith, No. 19-CV-7998 (VEC), 2021 U.S. Dist. LEXIS 13384 (S.D.N.Y. Jan. 25, 2021), available at <https://www.wolfpopper.com/siteFiles/News/Merrill-Ruling-on-Motion-to-Amend.pdf>.

10 Merrill Edge Self-Directed Investing Client Relationship Agreement dated May 2024 (<https://perma.cc/JJA2-2M6X>).

11 Margaret McCrary v. Merrill Lynch, Pierce, Fenner & Smith Inc., Case Number: 1:23-cv-10768-VM (S.D.N.Y.) available at [https://www.wolfpopper.com/siteFiles/Cases/Merrill\\_Complaint.pdf](https://www.wolfpopper.com/siteFiles/Cases/Merrill_Complaint.pdf). There is no claim asserted arising for March 2020 through March 2022 because over that period the federal funds rate and competitive market interest rates were essentially zero, across the board, in response to the Covid-19 pandemic.

12 The Wealth Advisor, July 31, 2024, “Wells Fargo Sued For Low Returns On ‘Cash Sweeps’” (<https://perma.cc/F9P8-WN7V>).

Wolf Popper LLP is also counsel in a class action lawsuit against E\*TRADE and Morgan Stanley Smith Barney LLC arising from similar conduct.<sup>13</sup> Similar to Merrill, E\*TRADE has paid retirement investors rates as low as 0.01% APY for sweep balances up to \$499,999—effectively no interest—which, the plaintiffs allege, violates the pertinent brokerage agreement terms requiring payment of “reasonable” interest rates.

Finkel told the *Financial Advisor* that with the shift to electronic notifications and brokerage statements, customers “don’t really look at account statements anymore,” and that they tend to focus on equities holdings, not their sweep rate, even though they may have significant cash holdings. “So the banks take advantage of people who aren’t really looking or who don’t understand.”<sup>14</sup> A recent Vanguard Investments study emphasizes that “[t]here are many reasons to expect IRA cash to be ‘sticky,’ [i.e., resistant to change] such as inertia (investors simply do nothing), inattention (investors are unaware of the cash), lack of financial literacy (investors mistakenly believe that money market funds are invested in the stock market), and risk aversion (investors fear losing money).”<sup>15</sup>

Consumer lawsuits similar to the ones Wolf Popper is prosecuting have also been brought against Ameriprise Financial Services, LLC and LPL Financial LLC. And the Securities and Exchange Commission has taken note, launching investigations into the sweeping of advisory account cash balances at various brokerages into low-yielding affiliated products.<sup>16</sup> For example, Morgan Stanley disclosed in its recent quarterly filings that it has been cooperating with an SEC investigation since April. The SEC appears to be particularly focused on whether sweep programs comply with the Investment Advisers Act of 1940, which imposes fiduciary duties on firms managing client funds. Wells Fargo has acknowledged engaging in “resolution discussions” concerning a similar SEC sweep investigation. The SEC is also investigating the now-defunct First Republic Bank<sup>17</sup> and AssetMark, an asset management provider.<sup>18</sup> Sweep accounts are “a massive vehicle for profits for banks,” Finkel told *Think Advisor*. “I suspect that the cash held in those accounts across the industry is in the trillions, and if banks needed to start paying higher rates, it would have a material impact on profits.”<sup>19</sup>

Regulatory focus on broker use of client cash is not new. In 2022, the SEC reached a \$187 million settlement with Charles Schwab subsidiaries arising from allegations that they failed to disclose how



13 Sergey Burmin and Kenneth W. Luke v. E\*TRADE Securities LLC and Morgan Stanley Smith Barney LLC, Case Number: 2:24-cv-00603-ES-MAH (D.N.J.) available at [https://www.wolfpopper.com/siteFiles/Cases/ETRADE\\_Initial\\_Complaint.pdf](https://www.wolfpopper.com/siteFiles/Cases/ETRADE_Initial_Complaint.pdf).

14 Financial Advisor, July 24, 2024, “Brokerages Boost Cash Sweep Account Rates To Quiet Outflows, Lawsuits” (<https://www.fa-mag.com/news/brokerages-up-cash-sweep-account-rates-to-quiet-outflows-lawsuits-78914.html>).

15 Vanguard Policy Research, July 2024, “Improving retirement outcomes by default: The case for an IRA QDIA” (<https://perma.cc/WA4D-J4K2>).

16 GRIP, August 8, 2024, “Banks and brokerages face SEC probe over interest payments” (<https://perma.cc/EPT6-V6PW>).

17 <https://www.sec.gov/enforcement-litigation/administrative-proceedings/ja-6030-s>.

18 <https://www.sec.gov/newsroom/press-releases/2023-199>.

19 Think Advisor, August 7, 2024, “SEC Probes Morgan Stanley, Wells Fargo Over Cash Sweep Accounts” (<https://perma.cc/C37C-TG9L>).



a robo-advisor platform, Schwab Intelligent Portfolios, monetized large cash holdings in client portfolios to generate revenue.

In response to increased scrutiny, on a July 12, 2024 earnings call, Wells Fargo announced increases on cash sweep accounts for advisory brokerage customers. A few days later, on July 16, 2024, Morgan Stanley implemented similar rate increases.<sup>20</sup> With the proliferation of civil lawsuits and increased attention from regulators, the coming months will prompt financial institutions to continue to evaluate the rates of interest they should pay on swept cash.

Consumers seeking legal advice with respect to their sweep accounts or other investments may contact Robert C. Finkel at [rfinkel@wolfpopper.com](mailto:rfinkel@wolfpopper.com) or at (212) 451-9620.

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20 Morgan Stanley Q2 2024 Earnings Call Transcript, July 16, 2024 (<https://seekingalpha.com/article/4704396-morgan-stanley-ms-q2-2024-earnings-call-transcript>).



## About the Authors

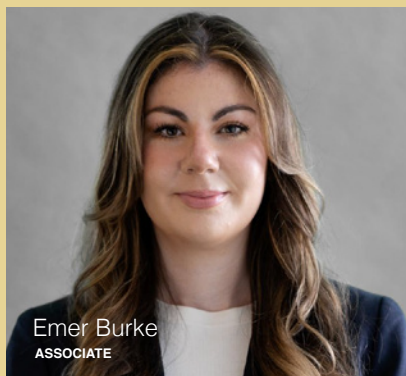
**Robert C. Finkel** is a graduate of the Columbia Law School, Class of 1981 (where he was a Harlan Fiske Stone Scholar), and the University of Pennsylvania, Class of 1978, where he obtained a B.S. in accounting from the Wharton School of Business and a B.A. in history from the College of Arts and Sciences. Robert began his employment in the 1980s with two large New York City defense firms. Robert has been repeatedly designated a Super Lawyer® in Securities Litigation.

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**Adam Blander** joined Wolf Popper LLP in April 2015 and was elevated to partner effective January 1, 2021. His practice focuses on commercial, corporate governance, securities, and consumer rights litigation. Adam has been recognized by Super Lawyers as a Rising Star in securities litigation in the New York metropolitan area from 2017 through 2022.

Before joining the firm, Adam clerked for New York State Supreme Court Justice Barbara Jaffe. A graduate of McGill University (with great distinction) and a Brooklyn Law School Health Law and Policy Fellow (cum laude), Adam's note "Codifying Common Law: The Self-Critical Analysis Privilege and the New Jersey Patient Safety Act," 21 J.L. & Pol'y 577, was published in the Journal of Law and Policy in 2013. Adam also served as a research assistant for Professor Aaron Twerski and the late Professor Richard T. Farrell and as an intern with the Health Care Bureau of the New York State Attorney General's Office. In 2011, Adam won the National Law Review's Student Legal Writing Contest for his essay on a tax issue.



**Emer Burke** is a graduate of the National University of Ireland, Galway (B.C.L., 2015). As a requirement of obtaining her international law degree, Emer spent one year of her studies attending the Université Toulouse 1 Capitole in Toulouse, France where she studied law through French. Before moving to the United States from Ireland, Emer completed several prestigious internships including a placement at the Office of the Director of Public Prosecutions (the Irish equivalent to the Attorney General).

Emer moved to New York after obtaining her law degree and has gained valuable experience working in a range of areas including immigration law, real estate law and litigation. Prior to joining Wolf Popper, Emer worked as a Managing Clerk at the law firm Shearman and Sterling, LLP where she became highly proficient in civil procedure and legal research. Emer is admitted to practice in New York.

## About Wolf Popper LLP



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