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Opinion: The Cash-Sweep Lawsuits Make a Strong Argument–for Fiduciary Advice

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By **Gil Baumgarten**

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Never has cash been so controversial in wealth management.

Merrill Lynch, Wells Fargo, LPL, and many other brokerage firms are currently facing lawsuits over the low interest rates they pay on accounts that hold clients' uninvested cash. The hoopla over cash sweeps—which has attracted regulatory notice as well—hinges on whether clients are entitled to the highest rate available.

Although I've criticized egregious brokerage practices in the past, I don't find this brokerage behavior to be nefarious. Let me explain why.

After interest rates collapsed in 2008, the interest earned on money funds was insufficient to support their administrative costs. Brokerages bellied up to the bar and offered customers positive returns in their money funds of 0.01%—despite the actual return being around -0.39%—and ate the losses. Imagine the reputational damage brokerage firms could have incurred if they hadn't done so and disengaged clients realized firms were charging them money to store their cash.

Instead, the brokerages mitigated the hit to profits by sweeping cash to their own banks to be lent to other customers while avoiding the costs inherent in sw
fund.

Fast forward to 2019, when many discount brokerages dropped th
to zero. For a time it seemed as though these brokerages had sque
blood from the client revenue turnip.

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However, a new way to earn profits emerged when interest rates r
brokerages kept those sweep-to-bank practices in place, and the revenue earned from cash balances at their banks helped them recover prior losses. It is important to note that the brokerages never suspended or prevented the use of money funds, rather they only removed the automatic sweep-to-money-fund feature.

Limits of client entitlement. It is a reach to argue that clients were somehow entitled to higher returns on cash when, all along, the brokers or clients could have simply asked for a money fund purchase instead—or could even have done it themselves online.

Yet, lawsuits are now flying from people suddenly awakening from their slumber. I think it will be a very tough sell indeed to claim that brokerages "owe" their customers the highest returns on cash available, especially when the brokerages previously ate losses on those same customers' behalf.

Brokerages aren't public service entities; they are for-profits. It seems that customers have become spoiled into thinking that prices will forever decline while services improve.

Despite the SEC's Regulation Best Interest, which took effect in 2020, the standard of care for brokers is still not fiduciary nor truly in the client's best interest. All the requirements in Reg BI are easily resolved by mere disclosure of conflicts, not cessation of conflicted advice.

Brokerage customers have no legal entitlement to returns they could have achieved by placing an online trade themselves. We've made daily money fund trades on behalf of hundreds of clients in our wealth management practice over the past few years. The cash sweep trades have totaled nearly a billion dollars and our primary broker, Charles Schwab , has willingly accepted the trades with zero obstruction. One simply had to have been paying attention.

If we open the entitlement can of worms, what's next? Should we be able to turn back the clock and buy Nvidia shares a thousand points ago? Say adios to your free commission accounts.

The fiduciary is in. Now, I can get on board with claims that advisory relationships have a very different set of entitlements and allegiances than simple brokerage arrangements. Clients who pay fiduciary fees *are* entitled to better treatment, even if a nonfiduciary broker is providing the advice. I think an advisory relationship requires a higher standard of care.

Seeking optimal outcomes for clients isn't the role of a brokerage—
a fiduciary, which brokerages aren't.

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Brokerages are entitled to earn revenue. Investors waking up to th
ask what they are owed due to their own prior neglectful behavior
not hired a fiduciary advocate to navigate these complicated issue
more evidence that when all is said and done, the independent fid
will be the last man standing.

***Gil Baumgarten**, president of Segment Wealth Management, has 40 years of advising experience, formerly as a broker and currently as a fiduciary. He is the author of FOOLISH: How Investors Get Worked Up and Worked Over by the System. He has been ranked 10 times on Barron's annual list of the Top 1,200 Financial Advisors in the U.S.*

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