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**MONEY**

# Investors Get Shortchanged on Interest

## NYSE Says Some Brokerage Firms Are Steering Clients to Accounts That Deliver Sub-Par Rates

By **AARON LUCCHETTI**  
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The New York Stock Exchange yesterday issued a warning to brokerage houses who may be sweeping billions of dollars of their clients' cash into special accounts that pay lower interest rates than money-market funds.


The NYSE said brokerage houses sometimes fail to disclose prominently that these so-called cash-sweep accounts often are inferior to money-market funds. In a letter posted on its Web site and sent to about 300 brokerage houses, the exchange warned the industry that it could face new rules or possible enforcement actions if disclosure doesn't improve.

Brokerage houses typically offer two options for investors who want a convenient place to set aside cash: The bank-deposit cash-sweep account and money-market funds. The cash-sweep option, which the NYSE has targeted, acts like a savings account, with insurance features and lower rates. Money-market funds closely follow short-term interest rates targeted by the Federal Reserve and charge a management fee. While some firms offer clients a choice upfront, others steer clients to one product or the other.

The sweep issue, which has been growing in recent years, affects millions of individual investors, who use these accounts to pursue defensive strategies or park money between transactions. More than \$350 billion is tucked away in bank-deposit cash-sweep accounts at brokerage houses, according to iMoneyNet, a research firm specializing in short-term cash investments.

"As we became more familiar with the practices, we became more concerned that customer interests may not be properly accounted for here," says Grace Vogel, executive vice president of member-firm regulation at the NYSE.

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## WHERE YOUR CASH GOES



Brokerage firms offer two main cash options for clients:

- **Money-market funds:** These mutual funds, which levy a management fee, mirror prevailing short-term rates.
- **Bank-deposit sweep accounts:** They often pay less than money-market funds but are insured.

Some cash-sweep accounts are competitive with money-market funds. Others studied by the NYSE offered 0.2 to 0.6 percentage point less than money-market account rates. For an account of \$1 million, each lost percentage point adds up to \$10,000 a year.

The stakes are going up as interest rates move higher. That is because as short-term interest rates rise, money-market fund rates shoot up quickly, making them more competitive against sweep products.

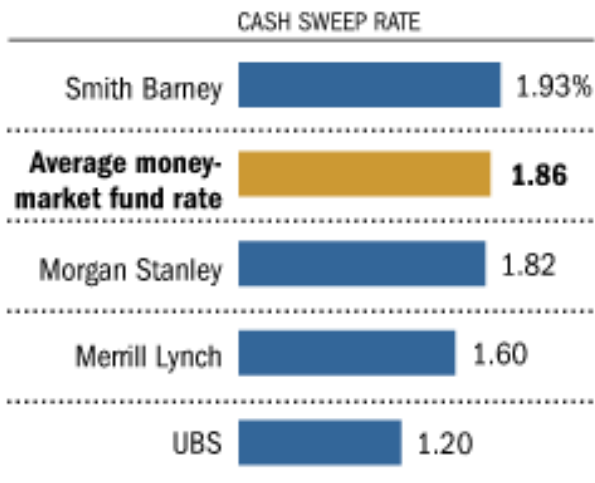
Ms. Vogel says the exchange is considering new rules outlining when brokerage houses have to get consent from customers to switch to a bank-deposit sweep product from a money-market fund. More brokerage houses have been using these cash-sweep accounts as the default parking spot for clients' extra money.

Some of the largest brokerage houses, such as **Merrill Lynch & Co.**, **Morgan Stanley** and **Citigroup Inc.**'s Smith Barney unit, offer the sweep product through their own banking units. Such firms "seek to earn two to four times as much" by switching their customers to bank-deposit products from money-market funds, a recent iMoneyNet report says. Many, it adds, start investors off with a high teaser rate that decreases later. The NYSE also is looking into making sure the long-term interest rate is clear to investors.

"We've seen numerous instances of programs that if customers were paying attention, they wouldn't opt to have their cash balance swept to a bank deposit," Ms. Vogel says. Clients can call their broker to find out what kind of account their cash is parked in. The NYSE suggests that brokerage houses make it easier for investors to find such information over the Internet or phone.

## Good Rates, Bad Rates

What four leading brokerage firms pay their clients in their cash sweep accounts, assuming a \$250,000 balance.



Sources: iMoneyNet; Informa Research Services

Ms. Vogel says the exchange is recommending that firms bring their cash-sweep programs to the NYSE for review, adding that she doesn't anticipate any enforcement actions will come unless firms disregard or act contrary to its suggestions.

During the next three months, she says, some brokerage houses -- prompted by the exchange -- will be sending out notes to clients explaining they may not be earning as much as they can in cash-sweep accounts. The NYSE has also required several firms to get their clients' express approval before changing their money-market fund to a bank-sweep product.

The NYSE also is checking into whether the insurance features of the sweep accounts are being properly disclosed to investors. While bank deposits are federally insured to as much as \$100,000, many such accounts have well more than \$1 million, and the NYSE

regulators want to make sure clients understand the entire account isn't necessarily insured.

Since 2000, assets in brokerage houses' bank-deposit sweep accounts have grown 53% a year, according to iMoneyNet. Most of that has come from money-market mutual funds, which have a fiduciary duty -- unlike brokerage sweep accounts -- to get the best return for the client, the NYSE says.

The Big Board's warning is part of an effort to become more aggressive in the face of criticism about its policing efforts in recent years. Last March, the exchange hired Richard G. Ketchum, a former Citigroup lawyer and National Association of Securities Dealers head, to bulk up its regulatory presence both on and off the exchange's floor.

The NYSE separately faces sanctions from the Securities and Exchange Commission for not policing its floor trading firms better in the past. Last year, NYSE specialist firms paid \$247 million in penalties to settle allegations of abusive trading practices on the stock-exchange floor. The NYSE's regulatory unit participated in the investigation, but has taken some criticism that it didn't act more quickly and decisively to protect investors.

The push into cash-sweep accounts shows how NYSE is trying to branch out into new areas at a time when some critics are suggesting that regulators shouldn't be under the same roof as an exchange with its own business goals. The NYSE is a not-for-profit corporation, but its financial well-being and that of its floor-trading members rely in part on the flow of orders from firms that the exchange regulates.

To avoid conflicts of interest, the exchange separated the regulatory unit from the rest of the NYSE. Mr. Ketchum, the exchange's chief regulatory officer, reports directly to a committee of independent directors on the NYSE board.

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