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# Wall Street Cuts Yields on Investors' Cash

## Firms Shift Money From Money-Market Funds To Lower-Paying Accounts; How to Switch Back

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In a development that hurts investors, brokerage firms are quietly moving their clients' cash from money-market mutual funds -- the traditional default option -- into lower-yielding bank accounts.


The shift, which is bolstering brokerage firm profits, means that investors with large cash balances could lose thousands of dollars or more in annual interest payments. These accounts are where brokerages typically park the proceeds from investor stock sales as well as dividends. Some investors also keep their portfolio's cash allocation in such accounts.

The average taxable money-market mutual fund is paying an annualized yield of 2.89%, compared with an average yield of 1.53% on bank money-market deposit accounts, according to iMoneyNet, a Westborough, Mass., research firm. For an account of \$100,000, each lost percentage point adds as much as \$1,000 a year in lost interest.

Although investors can opt into higher-paying money-market funds, they need to take the initiative to do so by contacting their broker. And brokerage firms are increasingly raising their minimum balance requirements for clients to be eligible for the higher-paying options.

Where idle cash was sitting didn't matter so much a year ago, when yields on both types of accounts were below 1%. But since the Federal Reserve started boosting short-term rates in June 2004, money-market mutual fund yields have shot past yields on many of these bank-sweep

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**SWEEP STAKES**

- [See a sampling](#)<sup>0</sup> of what some brokerage firms are paying investors in their bank-deposit sweep accounts, assuming a \$25,000 balance, and how those yields compared to other sweep options.

**It pays for brokerage clients to find out where their cash is parked, since rates on different accounts vary widely.**

- Investors can call their broker to verify their account's interest rate and to have cash 'swept' into a higher-paying money-market fund.
- Some brokerage firms, but not all, provide the available sweep options and their rates on monthly statements.
- For more on sweep accounts, check out the NYSE's Web site: [www.nyse.com/pdfs/informedinvestor1.pdf](http://www.nyse.com/pdfs/informedinvestor1.pdf)<sup>1</sup>. ([Adobe Acrobat](#)<sup>2</sup> required)

products.

Starting Sept. 1, new customers at **Charles Schwab** Corp. with less than \$500,000 in household assets will have their cash swept into a deposit account at the firm's bank unit, and will no longer be able to choose a money-market mutual fund as a default sweep option. **Morgan Stanley's** Individual Investor Group, meanwhile, which currently has money-market mutual funds as the default cash-sweep option for its clients, is planning to make bank deposits the default option for more of its accounts later this year.

Brokerage firms defend the practice and say it has benefits for investors. They stress that, unlike money-market mutual funds, these bank-sweep accounts are insured by the Federal Deposit Insurance Corp. for up to \$100,000 per depositor. In fact, since it's extremely rare for individual investors to lose money in a money-market mutual fund, this insurance is not much of an advantage.

In February, the New York Stock Exchange warned brokerage houses that they could face possible enforcement action if they fail to disclose prominently that these so-called cash-sweep accounts often pay inferior rates to money-market funds. Although disclosure has since improved, the NYSE is continuing to monitor the issue and could take action.

Many full-service brokerage firms began moving investors' cash into bank-deposit sweep accounts in 2000, when **Merrill Lynch & Co. Inc.** launched one of the first bank-deposit sweep programs. The trend, though, is a relatively new one for the discount brokerage firms, which have suffered in recent years from a slowdown in trading by individual investors and lower commissions.

In April, **E\*Trade Financial** Corp. moved to a new rate structure that pays clients with bigger balances higher yields. The firm has swept about \$6.4 billion in cash out of multiple sources, including money-market funds, into its bank since it implemented its cash-sweep product in September 2003. And **Ameritrade Holding** Corp. is gearing up to move customers' cash into cash-sweep accounts at TD Bank once it closes its deal to buy TD Waterhouse, the online brokerage unit of Toronto-Dominion Bank.

Since 2000, about \$300 billion has been moved from money-market mutual funds to bank accounts at brokerage firms, according to iMoneyNet -- and as much as \$100 billion that would have gone to money funds went to sweep accounts instead.

Brokerage firms say that changing the sweep option will bring more business to their banking units -- by making clients more comfortable using their banking services and keeping more of their assets in house -- and that this will help allow them to pay higher rates on other banking products or to trim trading fees.

Morgan Stanley says it is changing its program to be consistent with offerings in the marketplace, according to a company spokeswoman, while other firms, such as E\*Trade, say the moves are part of their efforts to integrate their banking and brokerage businesses. Charles Schwab says its moves are a result of "changes in the marketplace" and its business.

Some brokerage firms have built in rate increases to their bank-deposit sweep accounts to make them more attractive to clients. **Citigroup** Inc.'s Smith Barney unit, for instance, pegs the rate on its account to the firm's taxable money-market mutual fund.

Investors can call their broker to find out what kind of account their cash is parked in. In some cases, they can request to have their cash automatically swept into a higher-paying money-market mutual fund. **Bank of America** Corp., for example, provides a yield comparison on customers' monthly statements of all the sweep options available for its Money Manager Account, a brokerage account that sweeps cash to either an FDIC-insured account or to one of five money-market mutual funds. In recent months, the bank says it has seen more customers change the default to money-market mutual funds from FDIC-insured sweeps as money-market rates have climbed.

"Companies are definitely trying to squeeze more profit out of existing relationships," says Matt Snowling, an analyst at Friedman, Billings & Ramsey & Co. In certain cases, however, customers with very small balances -- usually less than \$5,000 -- whose cash would typically earn nothing sitting in a brokerage account would earn more if their cash was swept into a bank-deposit sweep account. Yields on FDIC-insured accounts may also be higher than money-market mutual funds when interest rates are falling.

Shifting cash to bank-sweep accounts can be enormously profitable for the brokerage firms, since they can usually earn more money by reinvesting those deposits in higher-yielding securities or loans, which they are prohibited from doing with the money funds they manage. E\*Trade, for example, says it has been able to lower the bank's funding costs or liabilities by replacing third-party borrowings with a lower-cost source of deposits.

Of the \$103 million in revenue "synergies" that E\*Trade expects to generate from its acquisition of Harrisdirect, a unit of **Bank of Montreal**, about \$75 million should come from sweeping \$3 billion in cash from Harrisdirect customers to the bank's sweep accounts.

Ameritrade, for its part, expects to generate close to \$200 million in additional revenue from its acquisition of TD Waterhouse by moving customers' cash into TD Bank. And Schwab, which has started to move into cash-sweep accounts "conservatively," could sweep as much as \$18.8 billion in its clients' cash into the bank -- which could boost its 2006 earnings by another 12 cents a share, estimates Richard Repetto, an analyst with Sandler O'Neill & Partners.

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