

The Informed Investor

The Cash Sweep Account: What Deal Are You Getting?

Are excess cash balances in your brokerage account being automatically swept to a money market fund or to a bank deposit? If they are, this inaugural edition of “The Informed Investor” will provide you with valuable information to help make a knowledgeable decision with respect to your investment.

Brokerage firms have chosen to offer varying ways of managing cash balances in customer accounts. Some firms offer one or more money market mutual fund while others offer accounts deposited in an affiliated or third party bank. Several offer both. At some brokerage firms, customers are offered a choice. At others, the funds are directed at the discretion of the firm.

While an investment company, such as a money market mutual fund, is required to seek the highest rates prudently available, your brokerage firm has no similar obligation when it comes to the cash in your sweep account. In fact, your brokerage firm may receive payments for introducing your cash sweep account to a bank. The bank, in turn, may pay a lower interest rate on your funds.

Questions to Ask

To fully protect your investment dollars, here are some of the questions you should ask yourself and your broker or customer service representative:

Q: What choices are available for investment of my cash balances?

A: Your brokerage firm can manage your cash balances or you can take a more active approach. Your selection will depend upon your investment objectives and how liquid you want the balances to be. Will you have a need to access your cash in the near term or is the time period longer? Once this question is answered, you should compare the rates available on common money market instruments, including short- and long-term money funds, certificates of deposit or Treasury bills and notes, as well as the bank deposit sweep program that may be offered by your brokerage firm. You should also inquire if your brokerage firm offers choices for cash sweeps that include money market alternatives and compare the benefits of having your cash balances swept to a bank versus these money market alternatives. Then make your decision.

If tax-free income is advantageous to you given your income tax bracket, you may want to include in your comparison of rates a tax-free money fund. You may also want to consider whether other types of investments may be more effective in achieving your investment goals.

Q: Are these introductory rates? If so, what is the longer-term rate?

A: Some firms offer an inducement to sign on to a new program with “teaser” rates of limited duration. Your broker-dealer should be able to tell you if this is an introductory rate so that you can make an educated investment choice.

Q: Where can I obtain current information on available rates for bank and alternative short-term investments?

A: As interest rates change, an investor may want to reevaluate an investment to obtain the most favorable rate available. Therefore, you should determine whether current rates are posted on a website or if there is a toll-free number or other means available to obtain current rate information.



Q: Is there any benefit to selecting a bank deposit over a money fund?

A: Bank deposits up to the Federal Deposit Insurance Corporation (FDIC) limit of \$100,000 are not subject to credit risk, whereas money funds invest in securities that may have interest rate and/or credit risk. While managers attempt to keep the value of money market funds at a stable price, normally \$1.00, there is no guarantee that they will be able to do so.

Q: If my funds are being swept into a bank deposit account, whom do I call to gain access to these funds?

A: Because some brokerage firms have arrangements with banks that allow recordkeeping to be done by the brokerage firm, the bank may not know the name of individual customers. So, ask your broker or customer service representative—especially when you open the account or at the inception of the bank deposit arrangement.

Q: How long will it take to obtain my funds?

A: The length of time will vary according to your brokerage firm.

Q: Will the bank give me a passbook or certificate?

A: No. Your funds will be indicated on your regular brokerage account statement.

Q: If my cash is swept to a deposit account at a bank, is it eligible for FDIC insurance coverage?

A: Yes, subject to the rules of the FDIC and normal recordkeeping at your broker.

Q: If it exceeds the FDIC limit at a bank, is excess insurance protection available? Can I establish multiple accounts at a bank?

A: Sometimes brokerage firms offer cash sweep accounts at multiple banks that are FDIC-insured up to \$100,000 each. They may also hold deposit accounts (including certificates of deposit) with the same bank in separate capacities. For example, you may have a deposit account for yourself in your name and also maintain a deposit account at the same bank as a trustee for another person under a trust arrangement. Or you might have one deposit account in your name at a bank and a joint account at the same bank with your spouse. Each would be FDIC insured, subject to FDIC regulations.

Q: Who is responsible for monitoring an account to make sure it does not exceed the \$100,000 limit for FDIC insurance?

A: You, the customer, are responsible.

Q: Does my brokerage firm need my consent to move my cash balance from one investment to another?

A: Some brokerage firms have contractual language in their customer agreement, that may have been signed before implementation of a new program or changes to existing program, that gives the firm the authority to adopt or amend the cash sweep plan without further consent from the customer. Often, disclosure of changes to exiting plans may be made through newsletters, statement stuffers or similar mass-mailed documents. If you wish to revoke your consent to a bank sweep, talk to your broker or customer service representative.

NYSE Regulation issued an Information Memo to its member organizations on February 16, 2005 suggesting best practices with respect to prospective disclosure in this area to customers. If you would like to read the Memo, please visit nyse.com/regulation, “Information Memos,” and “05-11.”

To obtain more specific information relative to your personal affairs, you may wish to contact your professional adviser.