

MONEY FOR NOTHING

NOVEMBER 2007

In a deal worthy of comparison to the United Nations Iraq oil for food scam due to its moxie and effectiveness, I give you the **Big Brokerage Money for Nothing Scandal**. This has nothing to do with Dire Straits, Sting or early MTV videos (before they turned into soft-core porn). This has to do with a ploy so brazen that it was pulled off right in front of investors eyes without anyone noticing for seven years.

Let's take the DeLorean with the flux-capacitor back to 2001...

You have a brokerage account at either Merrill Lynch, Citigroup/Smith Barney, Charles Schwab, or Wachovia with \$50,000 sitting in cash, in a money market earning 5% while you decide what high quality dividend paying asset you are going to buy, (not what your broker is pushing on you). Then all of a sudden the firm changes its policy and moves your cash into what they call a *deposit account*. This account rather than earning a modest 5%, now earns a paltry 1%.

Great deal for the bank! The banks will now take your cash and lend it out at 8% while you earn 1%. Garbage deal for you! This is a Wall Street version of "*Let them eat cake*", clients with larger accounts received more options and higher interest rates leaving the peasants with lousy rates and poor choices. This presents to us an obvious question...

Who in their right mind would accept a lousy deal like that?

If you were a client of one of the aforementioned brokerage firms with less than 1 million dollars in assets in the account you did. Bloomberg reported that beginning with Merrill Lynch in 2000, firms began telling clients that their money would no longer sweep into money-market funds but would instead go into deposit accounts in the brokerages affiliated banks. The banks could lend out the money or invest it for themselves which is not possible when the funds were invested in a money market. The switch has been a monumental success for...you guessed it...the brokerage firms. Merrill, Citigroup/Smith Barney, Morgan Stanley, Schwab, and Wachovia who are currently being sued for this practice took in a combined \$186 billion in deposits last year. This presents to us another question...

Why would account holders accept such an awful deal?

Sometimes I really think that many of the big brokerage firms have the power of Obi wan Kenobi and the force/Jedi mind trick. "*This is not the interest rate you think it is*" or "*We really care about our clients.*" The actual sales pitch from Merrill stated, "*Keep your money working with an automatic sweep.*" Morgan stated, "*Make your money work harder, your excess funds are never idle.*" What disgusts me is how the "*financial advisors*" allowed their clients to get shafted out of 400 basis points for no reason whatsoever than to enrich their firms bottom line. This is why the brokers at these firms cannot accept the responsibility of being a fiduciary to their clients. They do not look out for their client's best interest. If they had, they would have never allowed this to happen. When I see the big brokerage commercials on television with their sappy bull-excrement claims of being financial advisors I get bouts of nausea.

The firm's response to the lawsuit offers us an extraordinarily revealing insight into their true nature. Caution: This might give readers a bout of nausea as well.

From Bloomberg: **Merrill, Citigroup, Morgan, Schwab and Wachovia defended their sweep accounts in court, saying the lawsuit has no merit and asking the judge to toss it out. In their court filings, the firms say they have no obligation to pay the highest possible return**

on idle funds, nor did they ever promise to. (Who is handling their legal? Bill Clinton?) Broker-dealers are not and never have been required to sweep idle cash from brokerage accounts or pay any interest at all on cash balances. They say they fully informed their clients as to the changes in the sweep accounts.

From a June 6, 2001 Merrill Lynch disclosure...

“Merrill Lynch Banks will set interest rates based on economic and business conditions, and no longer link them to money-market fund rates. These changes will be financially beneficially to Merrill and its bank”.

Translation: Rather than give you the best possible rates possible on your cash balances we will put your cash to work for us in a manner that will best put money into our pockets and therefore make our Christmas bonus large enough so I can buy that Lamborghini I want. *Dramamine anyone?*

Bloomberg reports that there is a precedent set in a 1998 court case that bodes well for the brokerage firms in this case. I just wish the case received some attention because regardless of the outcome of the case, maybe a few investors might recognize the importance in working with a true financial advisor that will always put their interests first.

Woolner Ann [Merrill, Morgan, Citi Get Help From Clients Cash](#) *Bloomberg* November 16, 2007