Cash sweeps legal avalanche hits Ameriprise, LPL with new suits

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Minneapolis-based Ameriprise was hit with two new putative class-actions suits on Wednesday alleging it was sharing with clients too little of the money it makes from their uninvested cash held in brokerage and advisory accounts. That followed on a similar lawsuit filed on Tuesday against LPL.

Many of the actions make essentially the same claim: That firms juice their profits by investing or lending out clients' uninvested brokerage cash and then keeping the vast majority of the returns for themselves. For instance, one of the latest suits against Ameriprise — filed on the behalf of Mindy Bender, a former client living in New York — contends the firm sweeps the vast majority of clients' uninvested cash into its affiliated Ameriprise Bank.

Ameriprise, according to the suit, does not disclose how much of the returns it generates are kept for itself and what goes back to investors. The suit contends that Ameriprise should have made it clear that its affiliated bank isn't really like other banks.

"Ameriprise Bank was at all relevant times operated primarily to take advantage of the cash in Ameriprise's customers' accounts, which was directed to it through the Bank Deposit Sweep Programs," according to the suit. "This rendered Ameriprise a servant with two masters, beholden primarily not to its customers but to Ameriprise Bank. Indeed, Ameriprise Bank's assets — approximately 90% if not higher — is cash received from Ameriprise's customers' accounts pursuant to the Programs."

Defenders of cash sweeps often contend the accounts are meant for money that's held only temporarily before being put into stocks, bonds or other investments.

A spokesperson for Ameriprise said, "Our cash sweep is intended for money in motion, not as an investment option for significant cash balances over extended periods. Our programs comply with legal and regulatory requirements."

New suits, familiar claims

Like many of the other suits, the latest against Ameriprise accuses the firm of violating its fiduciary duties by not making adequate

disclosures and not looking out for clients' best interests. It also alleges gross negligence, breaches of Minnesota state law and other violations.

The firms bringing the suit, Berger Montague of Philadelphia and Rosca Scarlato of Beachwood, Ohio — have filed previous cases against Wells and LPL. Michael Dell'Angelo, an executive shareholder at Berger Montague and one of the lawyers working on the cases, said it's noteworthy that some firms began changing their disclosures after regulators and lawyers started questioning their cash sweeps programs.

Wells Fargo, for instance, disclosed last year in a regulatory filing that the Securities and Exchange Commission was making inquiries about its cash-sweeps program. Following that and lawsuits against some of Wells' rivals, Wells changed the language in its disclosures.

"The fact that large brokerages have changed their disclosures about how their cash sweep programs work and what clients should expect are certainly indicia that they recognized the disclosures that are being challenged are problematic and may not have been consistent with their fiduciary duty," Dell'Angelo said.

Firms have also been making changes to the rates they pay on sweeps accounts. Wells said in its second-quarter earnings that a recent rate hike would cost it $350 million this year. Dell'Angelo's suit against the firm calls that figure, "evidence of the massive windfall the Programs provide to Defendants at the expense of [Wells Fargo Advisors'] customers."

Morgan Stanley likewise expects an as-yet-unspecified hit to its bottom line from changes to its sweeps policies, and UBS is forecasting a $50 million bite out of its net profits from its decision to raise rates in the fourth quarter.

Law firms pile on

Dell'Angelo said he and his colleagues are looking at other wealth managers, and there's a chance more household names could be hit with similar actions.

"There are a lot of institutions that might be impacted by these types of allegations," Dell'Angelo said. "We're going through a process of sorting through and understanding where these problematic programs might be and where they may not be."

Other law firms are meanwhile entering the fray. So far, the bulk of the cash-sweeps cases have been filed by Dell'Angelo's group and another legal team consisting of attorneys from Simmons Hanly Conroy of San Francisco, Williams Dirks Dameron of Kansas City and Oakes & Fosher of St. Louis.

Another firm, the Gibbs Law Group in Oakland, California, came on the scene earlier this month with the third sweeps-related suit filed so far against Wells Fargo. The same legal team brought the new suit against LPL this week on behalf of a California resident named Hieu Vu. Gibbs is also working with Berger Montague on the second suit this week directed against Ameriprise, filed on behalf of a California resident named Mark Frey.

Separately on Thursday, the New York-based firm Bernstein Litowitz Berger & Grossmann announced it's forming a task force seeking to represent clients and depositors "who believe their cash holdings have been improperly swept into low-interest accounts by banks and brokerages." The firm is holding a webinar Monday afternoon to hear from people who think they may have been harmed.

Adam Wierzbowski, a partner at the Bernstein Litowitz Berger & Grossmann, said, "Our investigation is broad-reaching and not limited to the brokerages that are the focus of regulatory inquiries or pending class actions."

Sweeps changes could mean higher advisory fees

Industry analysts have meanwhile been trying to get their arms around what all this scrutiny of cash sweeps policies is likely to cost firms in the long run. Researchers at Moody's Ratings noted in a recent report on cash sweeps that regulatory inquiries and lawsuits are putting firms under some pressure to raise their rates.

But more of the impetus to increase sweeps payouts is coming from a simple need to compete for investors' cash, according to the report. With many firms raising their rates, wealth managers that don't follow suit may have a hard time retaining clients.

The Moody's report finds that large wirehouses like Morgan Stanley and Wells Fargo are best insulated from any resulting revenue hits because of their diversified lines of business. Broker-dealers like Charles Scwhab and Raymond James could be more exposed, according to Moody's, because they have fewer alternative sources of income to lean on.

"If competition intensifies and rates increase across the industry, wealth managers could try to compensate by charging new or higher fees elsewhere in their businesses; for example, by increasing advisory fees and commissions, reducing payouts to advisors, or charging new types of account fees," according to the report.

Jeff Schmitt, an analyst at the research firm William Blair, came to a similar conclusion in another recent report on firms' cash sweeps policies. Firms, he wrote, may even consider offsetting their losses by imposing custody fees of 0.02% or 0.03% on assets held in advisory accounts.

"On an account with $100,000 of assets, this would be a fee of only $20 to $30 per year and the end-client would be receiving a higher yield on sweep cash in return," Schmitt wrote.