Wells Fargo, Merrill paying $60M over sweeps policies

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Wells Fargo and Merrill Lynch agreed Friday to pay $60 million in total to settle SEC allegations that they didn't do enough to consider clients' best interests when placing their money in "cash sweeps" accounts.

The announcement came as the first major fine imposed since regulators and plaintiffs' lawyers started scrutinizing over a year ago how large firms handle clients' uninvested cash.

So-called sweeps accounts have been under a microscope lately following widespread allegations that wealth managers use them to pad their bottom lines rather than benefit clients. Cash sweeps refer to firms' practice of taking uninvested cash that investors hold in brokerage and advisory accounts and moving it over to affiliated or unaffiliated banks, where it can be lent out or invested.

A spate of recent lawsuits accuse wealth managers of sharing too little of the resulting returns with clients. The suits also fault firms for not directing clients' money into better-paying investments such as money market funds, Treasury bonds and certificates of deposit. The Securities and Exchange Commission's settlement said both Merrill and Wells Fargo had "cash alternative" products that sometimes paid at least 4 percentage points more than sweeps accounts.

The SEC specifically accused the firms of failing to have written policies and procedures requiring advisors to consider if their sweeps policies were really in clients' best interests, or if other options might be better. Instead, according to regulators, Merrill and Wells Fargo reaped substantial financial benefits by automatically "sweeping" billions of dollars in client assets.

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"These actions reinforce that advisory firms must have reasonably designed policies and procedures to consider their clients' best interest when evaluating potential sweep options for cash held in advisory accounts and to ensure that cash held in an advisory account is properly managed by financial advisers consistent with a client's investment profile," Sanjay Wadhwa, the acting director of the SEC's division of enforcement, said in a statement.

Sweeps lagged far behind rising interest rates

The scrutiny over cash sweeps reached a fever pitch last year after the Federal Reserve finished hiking its key benchmark rate 11 times to a range of 5.25% to 5.5% in a bid to tame inflation. Rates have since come down, likely making the difference between rates paid on sweeps accounts and other types of cash alternatives less glaring. But while they were on the way up, many firms weren't necessarily making sure their sweeps rates were keeping pace, critics say.

Of the $60 million in total fines announced Friday, Merrill owes $25 million, and two Wells' subsidiaries — Wells Fargo Clearing Services and Wells Fargo Advisors Financial Network — owe $35 million. Neither firm admitted to nor denied the SEC's charges.

Spokespeople for both Merrill and Wells Fargo pointed to recent changes their firms have made to their sweeps policies.

"As the SEC noted, Merrill took several significant steps before becoming aware of the Commission's investigation, including increasing the rates paid to advisory clients in Merrill's Bank Deposit Program, lowering the minimum thresholds for investing cash in certain money market funds, and adopting and implementing enhanced supervisory procedures," the Merrill spokesperson said. "In fact, Merrill was one of the first large firms to offer a significantly higher cash sweep rate for advisory clients' uninvested cash."

The Wells spokesperson said, "Our agreement with the SEC puts this broader industry matter behind us, and as the settlement states, we have already successfully addressed the issues covered by the resolution."

Merrill and Wells Fargo made sweeps changes

Wells Fargo and Merrill's parent firm, Bank of America — along with their industry rival Morgan Stanley — have both disclosed in regulatory filings that they were responding to SEC inquiries about their sweeps policies. Wells and Bank of America have also discussed planned sweeps changes in recent earnings calls.

Talking about Wells Fargo's second quarter results in July, Chief Financial Officer Mike Santomassimo said the firm was planning to raise the sweeps rates paid on certain advisory accounts and predicted the change would lower its net interest income by $350 million for the year. Wells reported Wednesday that its net interest income was down by $50 million in the fourth quarter as a result of "higher deposit costs including the impact of increased pricing on sweep deposits in advisory brokerage accounts, partially offset by higher deposit balances."

Bank of America meanwhile announced in its own earnings call in July that it had made pricing changes on certain deposits held at Merrill.

The SEC's settlement with Wells Fargo and Merrill credited the firms for making improvements to their cash sweeps rates and for cooperating in its investigation. The SEC looked at Merrill's sweeps policies from January 2022 to April 2024 and Wells Fargo's from 2019 to May 2024.

Since then, the SEC said, Merrill has "increased the rates paid to advisory clients" and "lowered the minimum thresholds for investing cash in certain money market funds." Wells similarly has "made improvements to its policies and procedures regarding the selection of cash sweep options for advisory clients and the allocation of client cash in advisory accounts," along with other remedial steps.

Sweeps suits pile up

Merrill and Wells Fargo are among a long list of firms that have been hit with lawsuits over their sweeps policies in the past year. In general, the suits — also lobbed at Morgan Stanley, JPMorgan, Ameriprise, UBS, LPL Financial, Raymond James, Charles Schwab and others — accuse wealth managers of violating their fiduciary duty to serve clients' best interests.

One of the lead attorneys in many of the suits, Alan Rosca of the Beachwood, Ohio-based firm Rosca Scarlato, said he was somewhat surprised to see the SEC's settlement with Merrill and Wells Fargo invoked neither fiduciary duties nor the companion Regulation Best Interest conduct rule for broker-dealers. Just as significant, though, was the SEC's decision to accuse the firms of violating provisions of the federal Investment Advisers Act of 1940.

That, to Rosca, clearly shows the SEC thinks uninvested cash triggers wealth managers' obligation to serve their clients.

"The SEC is saying that is part of your advisory business because clients have options and you are giving them only one option," Rosca said. "You could put them into a money market fund but you are instead putting them into a self-serving product."

SEC settlements don't provide binding precedents for court cases, and Rosca declined to say what he thought the deal with Merrill and Wells Fargo will mean for his lawsuits.

The nitty gritty on sweeps at Merrill, Wells Fargo

In seeking to justify their policies, large wealth managers often argue that cash sweeps are meant to give clients a safe place to temporarily park their money while they decide how they want to invest it. Many note that sweeps accounts offer protection by the Federal Deposit Insurance Corp., which guarantees up to $250,000 held in individual bank accounts. Money markets, by contrast, aren't covered by the FDIC.

The SEC's settlement with Wells Fargo says the firm, during the period under scrutiny, had only one sweeps account option for its clients. Money in those accounts was moved over to Wells Fargo Bank and other banks.

The SEC said Wells charges clients fees for managing money in sweeps accounts while also setting the rates paid on those holdings. Wells separately had money market funds, Treasury bond offerings and certificates of deposit that at times were paying as much as 5 percentage points more.

The SEC said Wells not only benefited from that difference in yields; its brokerage arm also received payments from Wells Fargo Bank and other banks for sending assets to them.

The agency also noted that Wells placed a limit on the amount of uninvested cash clients could hold in certain advisory accounts. But the upper threshold was set at 25% of their assets, a policy regulators deemed not "reasonably designed to monitor or regularly evaluate whether client cash was appropriately allocated on a timely basis according to a client's goals and objectives."

The SEC said the limit was lowered to 5% in October 2023 and then raised again to 25% last year after Wells started paying more on sweeps accounts. The SEC said Wells did discuss the workings of its sweeps policies in regulatory filings. But the disclosures were inconsistent, according to the SEC, and stated the firm had no "duty to monitor the Cash Sweep Vehicle for your account, or make

recommendations about, or make changes to, the Cash Sweep Program that may be beneficial to you."

Regulators lobbed similar allegations at Merrill. Merrill, according to the SEC, likewise offered only one type of sweeps account and moved cash out of it into affiliated banks. Merrill too could have offered various money market funds, Treasury investments, certificates of deposit and other cash alternatives sometimes yielding as much as 4 percentage points more.

The SEC said Merrill also disclosed the workings of its sweeps policies in regulatory filings.

"Merrill Lynch earned advisory fees on [sweeps] assets and was credited with revenue from affiliated banking entities based in part on the spread earned by banking affiliates on the [sweeps] Program," according to the SEC. "Merrill Lynch's banking affiliates earned significant net interest income on the [sweeps] Program deposits during the Relevant Period."