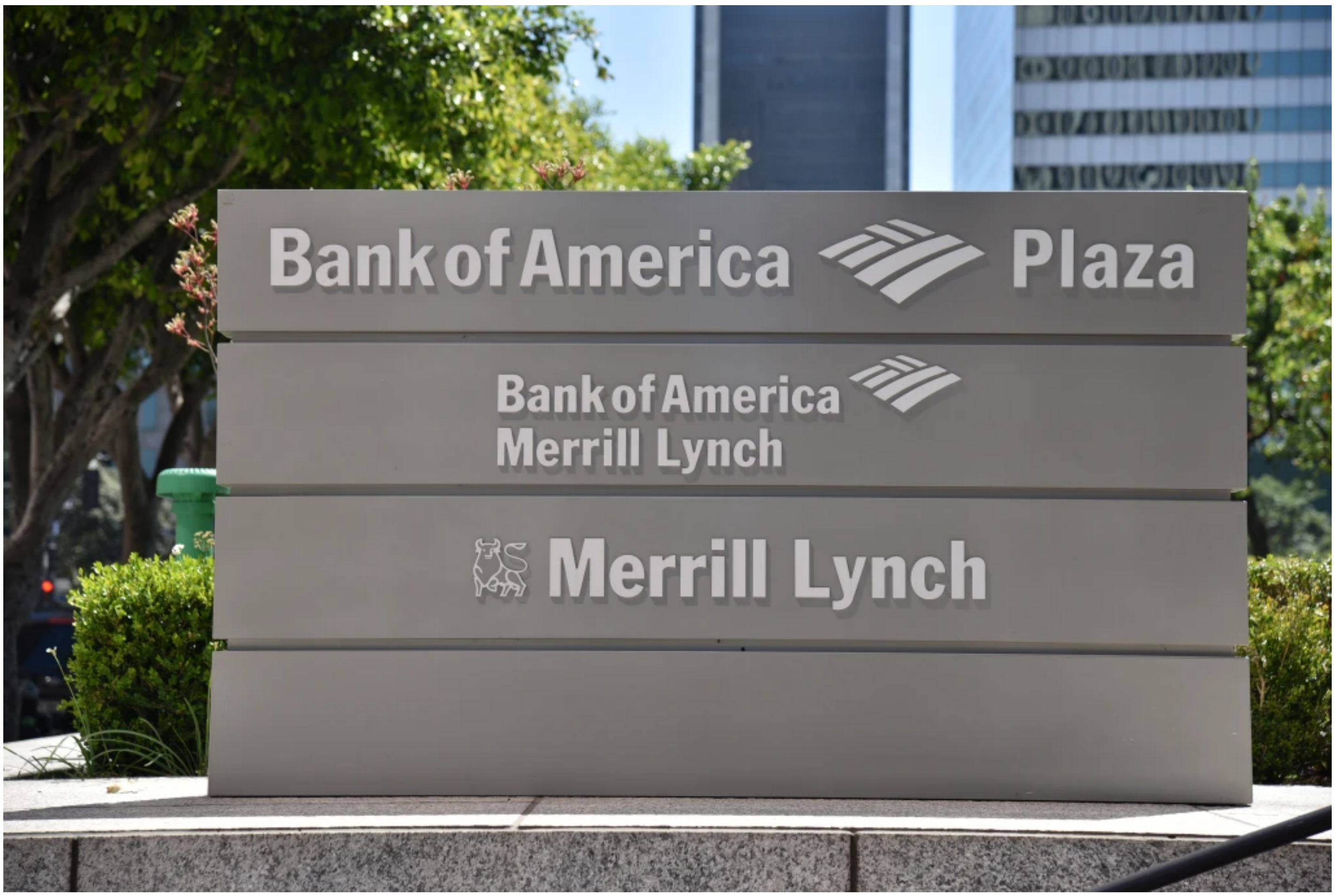
PORTFOLIO MANAGEMENT

Merrill Edge in hot seat over rates paid on IRAs

By Dan Shaw December 14, 2023, 5:46 p.m. EST 5 Min Read



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Amid heated debate about wealth managers' duties to retirement plan holders, Merrill Lynch has been hit with a lawsuit questioning its handling of money in a client's IRA.

individual retirement account through its Merrill Edge online trading system. The only plaintiff named in the action — Margaret McCrary — had a traditional IRA at Merrill Edge from October 2020 to March 2023.

During that time, McCrary, who lives in St. Clair Shores, Michigan, had about $500,000 sitting in cash in her Merrill IRA, from where it was "swept" into a Bank of America account paying a 0.01% return. That yield stayed the same even as inflation drove prices ever higher in 2022 and 2023 and the Federal Reserve responded by hiking its benchmark short-term interest rate 11 times from near zero to 5.25% over the course of a roughly year and a half period.

Over time, according to the complaint, McCrary came to notice that she was getting better rates on accounts she held outside Merrill — at Fidelity Investments and the regional lender Flagstar Bank. She moved the money held in Merrill Edge over to Fidelity in 2023.

Now she's asking for damages equal to the "reasonable" return she was entitled to under the Employee Retirement Income Security Act, known as ERISA for short. Michael Schloss, a former director of the office enforcement for the Department of Labor's employee benefits security administration, said her case will depend greatly both on what other services she was receiving through MerrillEdge and what she was paying for them.

Schloss, who's now at The Wagner Group law firm, said it's not really possible to do an apples-to-apples comparison with a rival provider like Fidelity. Firms, he said, will often differ from each other on everything from the services they offer to the fees they charge.

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"When you are a client for one of these financial firms, you are getting a whole slate of services. And how they price each element of those services and what returns they give, it's never in a vacuum," Schloss said. "So courts will want to look at the entire scope of the arrangement."

York.

"We've successfully defended against these claims for the last four years and will continue to defend ourselves in these matters," Merill said in a statement.

At the heart of the latest suits against Merrill is an ERISA rule preventing brokerages from sweeping money into an affiliated bank — Bank of America in this instance — unless they ensure they are providing a reasonable rate of return. Robert Finkel, the lawyers representing plaintiffs in both Merrill cases and a senior partner at New York-based Wolf Popper, said that requirement means she's entitled to compensation for all the time when federal interest rates began to outstrip her own yields.

"And if six months goes by and you look at your statement, for every month you have damages," Finkel said. "And after six months, if you get tired of the account and move, you still have damages for the time the rate wasn't reasonable."

The latest class action against Merrill comes amid rollicking debate over the obligations that financial planners have when they make recommendations concerning clients' retirement accounts. A proposal put forward by the Department of Labor on Oct. 31 would place managers of retirement plans under the same fiduciary duty now requiring advisors to always place their clients' interest first.

Schloss said that, regardless of what happens to that proposal, traditional IRAs already fall under special rules because of the tax-exempt status they enjoy under the tax code. It's estimated that 55 million U.S. households, or nearly 42% of the total, had an IRA in mid-2022.

Holders of the most popular kind of IRA, the traditional IRA, can invest money in the accounts tax-free up to certain annual limits. The current maximum is $6,500 for people 49 and younger and $7,500 for anyone older.

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The tax treatment effectively means traditional IRAs enjoy a government subsidy, Schloss said. The trade-off for firms that hold the accounts, Schloss said, is their obligation to pay reasonable rates on any money held in them.

"If you accept this tax-subsidized money, you agree to certain heightened duties," he said.

Besides firms' obligations to retirement plan holders, the case is also the latest to bring up questions about brokerages' "cash sweeps" policies. This refers to firms' practice of moving clients' uninvested money into internal and external were drawing scrutiny from the Securities and Exchange Commission.

Many critics of cash sweeps policies note that they tend to offer far lower interest rates than money market accounts. Fidelity's Government Money Market Fund, for instance, is now advertising an annual yield of 4.65%.

But such comparisons rest on shaky ground. In a decision handed down on April 12 in the Valelle case, U.S. District Judge Valerie Caproni said the rates on money markets and bank accounts are calculated in entirely different ways.

Money markets mainly take any savings invested in them and put it into government bonds. Their rates of return are thus tied closely to those bonds' yields. Money in banks is instead lent out and the returns generally depend on current borrowing rates.

"It is not surprising then, that at the end of the day, the resulting interest rates paid diverge," Caproni wrote.

Dan Shaw Reporter, Financial Planning

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While the "retirement security rule" comprises the main part of the potential regulation, other shifts in existing standards will affect financial advisors as well.

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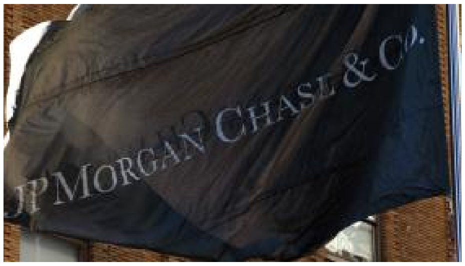

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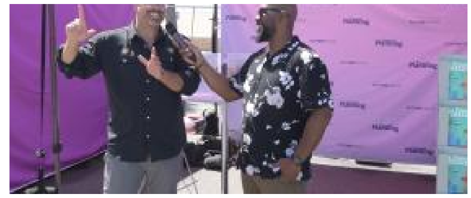

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