Despite lawsuits, Schwab slashes sweep yields 89% in five months, including two cuts in December -- raising risks for RIAs that don't sort cash, experts say

The Westlake, Texas brokerage was paying 0.45% as recently as last summer but in late December that was cut to five basis points, in 'calculated risk,' attorney says.

Author **Oisin Breen** January 8, 2025 at 8:19 PM

0 Comments

Ari Sonneberg: Schwab has calculated the risk ... [of] its 'how low can you go' approach.

Charles Schwab & Co. has quietly made a big tactical gamble that it can raise revenues by paying investors much less on sweep cash without losing clients or inviting more lawsuits.

The Westlake, Texas broker-dealer and RIA custodian slashed its sweep yield to 0.05% from 0.45% last summer, nearly an 89% reduction.

With a boiling frog gradation, Schwab cut its sweep yield to 0.2% in September, and 0.1% in early December.

Schwab's cuts last month came after Fidelity slashed its default RIA cash sweep rate to 2.19%* – a story that gained attention from several news outlets. See: Fidelity will default all RIA custody accounts into FCash.

Alois Pirker: Custodians are trying to see what they get away with.

Sweep yields are heading south for reasons that an RIA might imagine, according to Alois Pirker, founder and CEO of Marblehead, Mass. consultancy, Pirker Partners, via email.

“Custodians are trying to see what they get away with in this area. Clearly, Fidelity and Schwab are setting the tone,” he says.

For now, Schwab’s cash sweep balances are growing, up 5% to $393.7 billion in late Nov 2024 from $374.8 billion in Aug 2024.

Schwab declined to respond to two requests for comment.

RIAs on the hook?

Low RIA custodian sweep yields could get an RIA customer in trouble – even if it hasn't happened, yet.

“It's probably a matter of time [before an RIA gets sued], but not just time, a matter of money as well … It is a fiduciary issue,” says Ari Sonneberg, a partner at Boston law firm Wagner Law Group, via email.

Benjamin Edwards: it wouldn’t surprise me if there is liability on an individual level.

"There must, however, be a calculable loss … there has to be enough money at stake, [so] it becomes viable for a plaintiff’s firm to take a case.

“Find me a scenario where enough money is involved, and the client realizes that their advisor allowed some of their funds to go uninvested and become subject to a sweep with a grave opportunity cost, and I will find you a lawsuit for breach of fiduciary duty,” he adds.

But it's more than a legal issue if it harms goodwill with clients, says Ben Cruikshank, president of RIA cash management outsourcer Flourish, in an email exchange.

Rock-bottom' work-load

If you can put a number on it, there's a liability, University of Nevada Las Vegas law professor, Benjamin Edwards, told Citywire.

"If you're looking at millions lost, it's hard to say an advisor has been complying with their fiduciary duty of care, if they're just allowing [cash] to sit … It's the sort of conduct where it wouldn't surprise me if there is liability on an individual level," he says.

Ben Cruikshank: Advisors … may be in for some uncomfortable conversations.

The "rock-bottom" rates now on offer at a number of custodians, Schwab included, are also adding to the RIA workload, says Cruikshank.

"The steady drop in cash sweep rates offered by major custodians has been a constant headache for RIAs, forcing advisors to far more actively manage client cash holdings," he explains.

"What's emerged is that many firms [now] separate out 'operational' cash – typically 1% to 2% of client portfolios – versus cash held for 'reserve' purposes, then work to keep as little reserve cash in low-yielding sweep programs as possible."

But "advisors seem resigned to the drop in rates; they do what they can to benefit their clients and to mitigate risk … but have virtually no leverage to get their custodians to take a different approach," he says.

Other options

Pirker agrees that RIAs have little choice but to find better rates where they can.

"Fiduciary responsibility would require an RIA to look beyond cash rates and consider higher-yielding options," he says.

RIAs custodying with firms offering low sweep interest rates can still access higher rates, typically through managed accounts, money market funds, and CDs.

Schwab, for instance, offers access to several money market funds with yields ranging from 4.09% to 4.38%, and Altruist-custodied RIAs can get a 4% yield through the Altruist Cash service.

RIAs can also turn to outsourced RIA cash managers like StoneCastle, MaxMyInterest, or Flourish, which yield 4%, 4.41%, and 4%, respectively.

Risk vs. benefit

But cutting rates paid to investors also poses a range of risks for RIA custodians as they lend or reinvest the money at higher market rates and reap substantial revenue. The ten-year treasury rate hit 4.67% in today's trading.

Raymond Chun says Any sale of Schwab stock by TD Bank will not impact its deal on sweep cash with Schwab.

The risks range from upsetting RIAs or investors by creating more work to 'sort' cash for higher yields to provoking class action lawsuits or attracting regulatory attention.

Schwab has already been sued twice (see below) with the latest filed this past August. The suits contend that Schwab is failing to act in the best interest of its clients by paying so little on its accounts.

Wells Fargo, JPMorgan, Morgan Stanley, LPL Financial, Ameriprise Financial Services, and Raymond James also face similar suits, which they all claim have no merit.

Schwab is making a judgment call that it is doing the right thing financially and otherwise, Sonneberg explains.

“I don’t know if it's confidence [driving Schwab's further cuts], or simply the result of a risk-to-benefit analysis," Sonneberg says.

"It could be that Schwab has calculated the risk of continuing to test the waters [with] its ‘how low can you go’ approach, against the amount of money it stands to earn,” he adds.

‘Eye-roll’ or ‘outcry’?

Schwab is also far from alone in profiting from the net-interest ‘spread’ on cash held in ‘sweep’ accounts, but several firms offer much higher yields.

Start-up custodians like Betterment Advisor Solutions, would-be custodians like Robinhood, and established giants like Fidelity, all pay far more on sweep accounts than Schwab, with yields of 4%, 4%, and 2.19%, respectively. See: Fidelity reveals it switched its RIA sweep default to a much lower-yielding FCash product.

Start-up custodian Altruist pays just 0.2% on the spread; LPL pays out between 0.1% and 2%, depending on household AUM, although its higher rate only kicks in if there's more than $10 million of uninvested cash; and Wells Fargo pays between 0.02% and 0.2%, based on the value of uninvested cash.

Yet, Fidelity's late 2024 decision to nearly halve the rates it pays will frustrate advisors far more than Schwab's embrace of near-zero rates, says Cruikshank.

“There is definitely a sense that, because Schwab has always paid such low rates, it’s unsurprising they would go all the way to zero, and, unlike Fidelity, [Schwab] never held themselves out as paying attractive rates on sweep,” he explains.

“As a result, news of [Schwab cuts] is more likely to be met with an eye-roll than an outcry,” he adds.

Multiple suits

Schwab faces two separate suits over its sweep cash program, one of which links back to a deal with TD Bank in Canada, forged when Schwab bought TD Ameritrade in 2019.

The first suit, a class action filed in August alleges Schwab and TD Bank unfairly benefited from interest spreads due to an agreement that TD would administer a portion of Schwab's sweep cash through June 2031.

The TD “deposit agreement” will continue “on a go-forward basis” even if the bank sells its 10.1% stake in Schwab, Chief Operating Officer Raymond Chun* told his audience at the recent RBC Capital Markets’ Canadian bank CEO conference.

The second sweep suit against Schwab landed in early December, alleging that the brokerage giant failed its fiduciary duty by paying unfairly low rates.

"We support client autonomy by providing a wide array of options, educational resources, and ensuring security with FDIC insurance," a Schwab spokesperson told Citywire, at the time.

Meanwhile, expect sweep rates to keep going down if client reaction is any indicator.

Indeed, low default yields are unlikely to motivate most RIAs to move custodians, according to Pirker.

“I don’t think RIAs will change custodians for the cash sweep rates alone, especially if both major custodians have adopted similar strategies,” he says.

* *Fidelity’s FCash sweep provision does not apply to retirement accounts or retail accounts.*

* *Chun will take over as TD Bank CEO in April.*

with two full collections under his belt, Breen is also an academic in English Literature with a deep fondness for his Scottish rabbit, Hessell. @Breen

Brooke Southall and Keith Girard contributed to the editing of this article.

RIA Compliance | RIA Custodians

Fidelity Investments | Charles Schwab & Co.

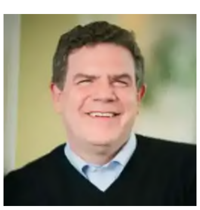
POST A COMMENT

Related Moves

RIABlitz: Vanguard technology • Pontera rebounds • Ex-HiddenLever's exec success • BlackRock rocked • Vivek's crypto • WF dunks SF? • Betterment dry option• Vestwell poached

The RIA firehose of news is rife with tactical moves to shore up voids, play catchup and react to a new concept of political tailwinds

January 10, 2025 at 10:01 PM



Biz Briefs: Schwab puts checks for $52 million in mail to robo-