

Put Your Company's Money to Work

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It's the New Year and I want to get off on the right foot, doing a good job at banking and managing my company's finances. I've heard about Sweep Accounts, as a tool to earn interest on money that is sitting around. We regularly have cash in our checking account, waiting for checks to come in and bills to be paid. It seems like a waste to have money being unproductive. Can you tell me about Sweep Accounts, and when to use them?

The purpose of a Sweep Account is to put money to work overnight, without having to take any specific action. A company's checking account is linked to an investment account, both held at the same bank. Overnight, extra money held in the checking account is moved, or "swept", into the investment account, in order to earn interest on the extra money. When funds are needed in the checking account to cover incoming checks, the funds in the investment account are "swept" back into the checking account. Neither the customer nor the bank has to take any action to have the sweep take place – it's automatic.

Sweep Accounts were originally created to get around old government laws (part of the Federal Reserve Act of 1933) that prohibited banks from offering interest on business checking accounts. The product started in the 1980's, when Sweep

Accounts were marketed only to large corporate clients, by large commercial banks. As of 2000, Sweep Accounts consisted of \$270 billion in assets under management. Today, money market funds account for nearly 40% of all Sweep Accounts. Other types of Sweep Accounts include commercial paper, federal funds, offshore instruments, trust instruments, and loan or credit sweeps, to name a few. Both large and small banks offer Sweep Accounts, smaller banks having almost twice the dollars / billion of bank deposits, as compared to the large banks.

The benefits of Sweep Accounts, for companies, include earning interest on funds, while having access to those funds to pay bills, without having to manually intervene to move money from checking to savings, or vice versa. For clients worried about safety, break investments into a variety of accounts, each with under \$100,000 on deposit – the limit for FDIC insurance. Depending on the bank, and the program, the client's funds may be swept into a larger cash pool, allowing for higher rates of return. In the case of a loan or credit sweep, overnight sweeps reduce the amount outstanding on a credit line, thereby reducing interest charges – which are usually greater than any interest the company may earn.

Today, banks offer Sweep Accounts as a competitive

strategy. What they offer varies greatly, and as a buyer you have to carefully check the details. Questions to ask include

- what are the balances that trigger a sweep
- what kind of minimum is required in my checking account, sweep account
- what investment fund options are available
- what interest rate is paid and are there any tiers to the interest paid
- what fees does the bank charge for the service – one time, per transaction, monthly fees, etc.
- how is interest accrued and paid
- what types of investment funds are available; what requirements are tied to specific fund options

Banks want to maintain some money in your checking account, as that is where banks make money – funds on deposit that do not pay interest. The three drivers of profit, both for the bank and for the client, center around fees, target balances and interest rates.

Banks realize several advantages by offering Sweep Accounts, primarily competitive. Clients are more likely to leave greater overall assets with the bank, to support the sweep account process, as opposed to moving funds to other investment options. Money market sweeps move funds off the bank's balance sheet, lowering the capital the



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bank needs to have on hand to meet stringent banking requirements. Sweep Accounts do generate fees, plus a spread between the interest paid to the client and the interest the bank realizes – estimated by some as four times the fee income. Finally, by building a closer working relationship with a client, the bank is likely to expand the total amount of services it sells to that client.

One place that clients have to beware is in the selection of investment accounts. Some investors have claimed that brokers steer them to accounts on which brokers received high commissions, even though those accounts paid the client lower interest. Clients must remember that an investment company, or bank, is in the business of creating and selling products. It is up to each client to shop for the best product to meet their individual needs, and to carefully investigate all of the details of how that product works.

Looking for a good book? Try Dictionary of Banking Terms by Thomas P. Fitch.

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