UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JUN 11 2007

CARLO DeBLASIO, RONALD KASSOVER, JEROME SILVERMAN, DEBORAH TORRES, MICHAEL SCHIRRIPA, ARTHUR KORNBLIT and CAROL WASHBURN, On Behalf of Themselves and All Others Similarly Situated,

Plaintiffs,

vs.

MERRILL LYNCH & CO., INC., MERRILL LYNCH, PIERCE, FENNER & SMITH INC., MERRILL LYNCH BANK, USA, MERRILL LYNCH BANK & TRUST CO., FSB, CITIGROUP INC., CITIGROUP GLOBAL CAPITAL MARKETS INC., CITIBANK, N.A., CITICORP TRUST BANK, FSB, CITIBANK SOUTH DAKOTA N.A., MORGAN STANLEY, MORGAN STANLEY & CO., INC., MORGAN STANLEY BANK, DISCOVER BANK, THE CHARLES SCHWAB CORP., CHARLES SCHWAB & CO., CHARLES SCHWAB BANK, N.A., U.S. TRUST COMPANY, N.A., WACHOVIA CORP., WACHOVIA SECURITIES, LLC, WACHOVIA BANK N.A. and WACHOVIA BANK OF DELAWARE, N.A

Defendants.

No. 07-cv-318-VM

SECOND AMENDED CLASS ACTION COMPLAINT

JURY TRIAL DEMANDED

I.

INTRODUCTION AND SUMMARY OF ALLEGATIONS

1. Plaintiffs, clients of Defendant brokerage houses and their affiliated banks, bring this class action on behalf of themselves and all others similarly situated, by their attorneys, Schoengold Sporn Laitman & Lometti, P.C., for their second amended class action complaint against defendants Merrill Lynch & Co. Inc., Merrill Lynch, Pierce, Fenner & Smith, Incorporated, Merrill Lynch Bank USA and Merrill Lynch Bank & Trust Co., FSB (collectively,

"Merrill Lynch"), Morgan Stanley, Morgan Stanley & Co., Inc., Morgan Stanley Bank, and Discover Bank (collectively, "Morgan Stanley"), Citigroup Inc., Citigroup Global Capital Markets Inc., Citibank N.A., Citicorp Trust Bank, FSB, and Citibank South Dakota N.A. (collectively, "Smith Barney"), Charles Schwab Corp., Charles Schwab & Co., Charles Schwab Bank, N.A. and U.S. Trust Company, N.A. (collectively, "Schwab"), and Wachovia Corporation, Wachovia Securities, LLC, Wachovia Bank N.A. and Wachovia Bank of Delaware, N.A. (collectively, "Wachovia") (all defendants collectively, "Defendants"). It is alleged that Defendants engaged in deceptive and misleading "cash sweep" programs, in breach of their fiduciary duties, whereby Defendants, acting in the role and guise of Plaintiffs' "Financial Advisors," caused billions of their clients' uninvested cash to be automatically swept – not into money market accounts or comparable savings accounts currently yielding 4%-5%, as was the previous practice and as any disinterested and unconflicted financial advisor would require – but into Defendants' owned and controlled bank accounts, so that defendants were able to use their clients' uninvested cash for ***their own profit***, achieving yields of 8% and higher, while paying their clients as little as less than 1% (collectively, the "Cash Sweep Programs"). It is alleged the Cash Sweep Programs violate the Investment Advisers Act of 1940 ("Investment Advisers Act"), 15 U.S.C. § 80b-1 *et seq.*, New York General Business Law § 349, which prohibits deceptive acts or practices, the Sherman Act, 15 U.S.C. §1, New York Stock Exchange ("NYSE") Rules 342.17, 401(a), 405, 472 and 476(a), and National Association of Securities Dealers ("NASD") Rules 2110, 2210 and 2310, and constitute common law fraud, breach of contract, breach of fiduciary duty, negligence, unjust enrichment, and negligent misrepresentation. This action is brought on behalf of clients of defendant firms who have had the uninvested cash held in their brokerage accounts at defendant firms automatically swept into low interest bearing bank

accounts (paying as low as less than one percent interest) at defendants' controlled and affiliated banks (the "Class"). Plaintiffs' allegations are based upon knowledge as to themselves and upon information and belief based upon, among other things, the investigation of their attorneys, including a review of Defendants' public documents, filings with the United States Securities and Exchange Commission ("SEC"), applicable statutes, rules and regulations, communications by Defendants, and news articles and information readily obtainable on the Internet.

Defendants State That Their "Relationships" With Clients Are As "Financial Advisors," Bound to Put the Client First, Holding Themselves Out As Investment Advisers and Fiduciaries

2. Over the last several years, Defendants Merrill Lynch, Smith Barney, Morgan Stanley, Schwab and Wachovia, through the investment of millions of advertising dollars and repeated explicit public representations, convinced Plaintiffs and members of the Class that Defendants act not merely as "stock brokers," but rather as "Financial Advisors" who provide a special relationship of trust and confidence, wherein the financial interests of the client come first. Thus, Defendants held themselves out as investment advisers and fiduciaries. For example, Merrill Lynch sought to deceive its clients in the "Client Commitment" section found on its Individual Investor webpage that "***our most deeply held principle at Merrill Lynch is clients come first***" (¶ 81); and Morgan Stanley, on the portion of its website devoted to the "Individual Investor", states that "***Obtaining your financial goals is number one on your list; it is also number one on your Financial Advisor's list.***" (¶ 155; emphasis added). Also, Schwab on its web page designated "Why Schwab," displays a picture of a professional woman who is shown with the quotation, "***For the first time, I feel like someone is really on my side.***" which is followed by the statement:

> Welcome to Schwab. Here you can enjoy a personal relationship with our investment professionals. ***We see investing from your perspective and make***

> ***recommendations based on actually listening to you and understanding your needs.*** (¶ 123).

(Emphasis added). The web page then links to an entirely separate web page dedicated to describing the Schwab "***Personal Relationship.***" (¶¶ 123-24).

3. Not to be outdone, Defendant Smith Barney was and is similarly unequivocal about the special "relationship" of trust its "Financial Advisors" provide to individual investors, stating that its clients should expect to disclose to their Smith Barney "Financial Advisors" their families' personal aspirations and fears:

> Just as your life involves more than investments, so will your relationship with your Smith Barney Financial Advisor. It all starts with a conversation. You might want to grab a chair, ***because you'll be asked about your fondest aspirations for yourself and your family, your feelings about where you are and where you hope to be and, of course, your fears, and the things that prevent you from getting what you want.***

(¶ 176; emphasis added).

4. Wachovia also made the same types of statements, assuring investors that:

> At Wachovia Securities, ***our Financial Advisors are committed to your financial welfare. They listen carefully and take a holistic approach that ties your financial objectives and needs directly to your life goals.*** As trained professionals, they have knowledge and resources to help you reach your financial goals.
>
> When you select a Wachovia Securities Financial Advisor, we realize you've chosen us over scores of alternatives in a highly competitive industry. ***As a firm, we'll work hard to continue to earn your trust each time we serve you.***

(¶ 212; emphasis added)

5. Defendants further deceitfully misled and misrepresented more specifically that, as Financial Advisors, they were committed to providing personalized guidance to ensure their clients' cash or short-term finances were effectively managed. Merrill Lynch described its cash management program as designed to "***Keep your money working with an automatic sweep***" and

stated that "***To ensure your money keeps earning interest, cash balances are automatically swept into your choice of tax-exempt money market funds or deposit accounts through the Merrill Lynch bank deposit program.***" (¶ 97; emphasis added). Schwab asserted "***We are committed to helping you earn an attractive return on your full portfolio including cash.***" (¶¶ 142-43; emphasis added). Smith Barney explained its cash management programs were designed to "***Make your money work harder. . . . In an FMA [Financial Management Account] account, your excess funds are never sitting idle.***" (¶¶ 174-75; emphasis added). Morgan Stanley described the benefits of its "Active Assets" account providing "***Practical investment features that keep your money working***" and "***Essential cash management services to simplify your financial life.***" (¶ 150; emphasis added). Finally, Wachovia described its "Command Asset" brokerage account as providing a "***Daily sweep with competitive rate.***" (¶ 216; emphasis added).

Defendants Historically Swept Clients' Uninvested Cash Into Money Market Funds

6. Thus, Defendants, by their affirmative misrepresentations, held themselves out as fiduciaries with their loyalties and trust to advance and enhance their clients' assets and accounts, including their cash holdings. It requires only a modicum of financial sense, however – far less than the fiduciary level of protection purportedly provided to Plaintiffs as "Financial Advisors" in a relationship of trust and confidence – to recognize that, for virtually all individual investors, it is preferable that the investors' uninvested cash be kept in money market funds, which have yields of 4%-5%, as opposed to checking or savings accounts with yields of 1% or 2%. (*See* ¶ 312, *infra.*) A money market fund is an open-ended investment company that invests in safe, short-term debt instruments, such as U.S. Treasury, federal agency or high-quality corporate securities, and that seeks to maintain a stable price of $1 per share while providing a

competitive rate of income. While bank accounts are Federal Deposit Insurance Corporation ("FDIC") insured and money market funds are not, the latter are universally accepted as highly safe investments – because of the quality and duration of the investments made – with little risk of default. (There has not been an insolvency of a money market fund in the last 35 years.) Further, it is the requirement of money market funds to try to maximize the yields for their shareholders, whereas banks have no such duty with respect to interest paid on savings accounts. Banks will never pay anything more than the represented rate of interest. As a result, money market funds have become a ubiquitous safe haven for cash investment, with over an estimated $2.3 trillion dollars invested in such funds in the United States. In fact, so safe and effective are such funds that even major banks such as JPMorgan Chase Bank, N.A. have begun to offer "money market savings accounts" in order to at least provide its bank customers with the higher money market yields of 4%-5% instead of the significantly lower 1% to 2% offered historically in bank accounts.

7. Traditionally, brokerage firms had "swept" all uninvested cash remaining in client brokerage or investment accounts into money market depository accounts. However, Defendants, beginning with defendant Merrill Lynch as early as 2000, saw an immense opportunity for their own profit if they would sweep *their clients' uninvested cash* – not into higher yielding money market funds for the benefit of their clients where Defendants were unable to use the funds for their own profit – but rather into accounts at banks *owned and controlled by Defendants.* Once the funds were in such brokerage firms' banks, Defendants would be able to use their clients' uninvested cash for their own investment or commercial lending. Thus, this plan and scheme constituted a clear conflict of interest between their clients' best interests and their own corporate interests.

Defendants Deceptively Devise And Implement Cash Sweep Programs To Reap Massive Profits From Clients' Uninvested Cash *At Clients' Expense*

8. The common plan and scheme thus implemented as "Cash Sweep Programs" instantaneously yielded Defendants *billions* of additional dollars to lend out and invest for their own profit. At the end of 2006, for example, Merrill Lynch subsidiary banks maintained $62.3 billion of U.S. bank deposits, which were "predominantly source[d] ... from our customer base in the form of our bank sweep programs and time deposits," (Merrill Lynch 2006 Form 10-K at 49) and even at the year-end 2000 – the first year of its bank sweeps program – Merrill Lynch attributed $45 billion in deposits at its subsidiary banks to bank sweeps. (Merrill Lynch 2000 Form 10-K at 9). In 2006 alone, Merrill Lynch was expected to record over $2 billion in ***profit*** just from the use of its clients' uninvested cash. Morgan Stanley, as a result of its implementing in November 2005 a program of sweeping its clients' uninvested cash into Morgan Stanley bank accounts, also achieved an exponential increase in the cash deposits in its banks. Morgan Stanley's cash deposits "for the benefit of its retail clients" increased by over **3,000% – *from $435 million in 2004, to $1.689 billion at the end of 2005, to $13.309 billion in 2006.*** Similarly, ***$10.7 billion***, or ***97%***, of Schwab's total banking client deposits of $11.02 billion at the end of 2006 were due to bank sweeps. Also, as of December 31, 2004, Wachovia's bank sweep "product" "captured $29.9 billion in deposits" – less than fifteen months from the program's inception, and this sum increased by $17.6 billion (to a total of $47.5 billion) as of December 31, 2005 (Wachovia 2004 Form 10-K at 25; Wachovia 2005 Form 10-K at 44). Not only did the cash sweep scheme provide Defendants with billions of additional dollars to lend or invest; it opened the door to immense profits, since commercial lending rates typically began at approximately 8% or higher (one or two points above the prime rate).

9. Ironically, instead of providing their clients additional compensation above

money market yields for allowing Defendants access to billions of dollars of additional cash for Defendants to lend or invest for their own profit – Defendants, in a clear conflict of interest and in violation of their fiduciary duties and applicable law, did the opposite. In perhaps the most wanton example of "Financial Advisors" breaching their duties to their clients' interests for their own financial gain, ***Defendants dramatically reduced the yields paid to their clients on the clients' uninvested cash to well below money market yields – to even as low as less than 1%.*** Thus, the simple arithmetic was that the clients (members of the Class) were receiving as little as less than 1% on their money – well below money market yields – while Defendants by virtue of their "cash sweep" plan and scheme were realizing up to 8% or higher. The Cash Sweep Programs blatantly violated NASD Rules mandating that the financial transactions proposed by brokers be "suitable" to the financial objectives of their clients since they served the financial objectives of Defendants *at the expense of their clients.*

10. So egregious was Defendants' "client cash grab" that Defendants well understood that they needed to take a number of well calculated steps – including a mixture of blatant misrepresentations and obtuse and misleading disclosures – in order to attempt to camouflage or conceal the deceit and fraud from their own clients and the public.

Defendants Deceptively Incentivize "Financial Advisors" So They "Go Along" With Deceptive Cash Sweep Schemes; Fiduciary Duties Violated

11. First, Defendants had to ensure that their own "Financial Advisors" would not give up the scam and provide their clients with the obvious "financial advice" that their uninvested cash belonged in money market accounts earning higher money market yields; or disclose that Defendants were reaping massive profits at their clients' expense as a result of these Cash Sweep Programs. Toward that end, Defendants effectively bought their Financial Advisors' silence by establishing that a portion of their "Financial Advisors" compensation

would be derived from the profit earned on their clients' cash swept into defendant banks. (Merrill Lynch ¶¶ 114-15; Schwab ¶¶ 147, 149; Morgan Stanley ¶¶ 173, 175; Smith Barney ¶¶ 196, 199 and Wachovia (¶ 241). Thus, the "Financial Advisors," who should have had undivided loyalty to their clients, became partners in this illegal plan and scheme to deceive and defraud. Monetary greed and conflict of interest replaced their undivided duty of loyalty, trust and care, all in violation of law.

Defendants Deceptively Structure Cash Sweep Programs So That The Least Sophisticated And Least Attentive Clients Are Most Adversely Effected

12. Second, Defendants created an artificial tiered structure within the Cash Sweep Programs so that, generally, their wealthiest and presumably their most sophisticated clients – who had assets of at least $1 million – would receive higher money market yields in their bank sweep programs and thus not balk. Defendants thus took most advantage of their smaller clients who held the least amount of assets and were least likely to detect Defendants' fraudulent practices. (Merrill Lynch ¶¶ 91, 93, 99, 101, 108, 111, 117; Schwab ¶¶ 131-34, 140, 14243, 145, 150; Morgan Stanley ¶¶ 162, 166, 169; Smith Barney ¶¶ 187-88, 192-94, 203; Wachovia ¶¶ 227-234).

Defendants Issue Blatantly False And Deceptive Statements That Sweep Programs Evidence Defendants Making Client Cash Work Hard To "Benefit" Clients

13. Third, Defendants blatantly misrepresented the Cash Sweep Programs as reflecting Defendants' effective management of their clients' cash. Indeed, Defendants' positive statements which touted their effective cash management noted above were made in the context of describing the Cash Sweep Programs which would best work for the clients. Thus, for example, it was in the context of describing the cash sweep "Bank Sweep Feature" – where the clients' cash earns as little as 0.96% – that Schwab stated "***We are committed to helping you***

earn an attractive return on your full portfolio including cash." (¶¶ 142-43; emphasis added). Smith Barney also was describing its sweep of client cash into its bank accounts when it inserted the heading "***Make our money work harder***" and stated, "***In an FMA account, your excess funds are never sitting idle***" (¶¶ 189-90; emphasis added). Merrill Lynch also was describing its sweep feature in its "Cash Management Account" program when it represented, "***Keep your money working with an automatic sweep***" and stated that "***To ensure your money keeps earning interest, cash balances are automatically swept into your choice of tax-exempt money market funds or deposit accounts through the Merrill Lynch bank deposit program.***" (¶ 97; emphasis added). Morgan Stanley was describing the benefits of its "Active Assets" account that included a sweeps feature when it stated, "***Practical investment features that keep your money working***" and "***Essential cash management services to simplify your financial life.***" (¶ 165; emphasis added). Finally, Wachovia described its "Command Asset" brokerage account as providing a "***Daily sweep with competitive rate***" (¶ 216; emphasis added).

Defendants Put The Burden On Clients To Object In Order For Cash Sweep *Not* To Go Into Effect

14. Fourth, Defendants ensured that the Cash Sweep Programs would be implemented *automatically* following issuance of the purported "disclosures," purposely putting the burden on the client to parse through the "Disclosures," and affirmatively object in order for the sweep programs *not* to go into effect, or conversely, silence constitutes assent. As a result, even though Defendants inundated their clients with pages and pages of purported "Disclosures," they ***made certain no reader of any of these purported "Disclosures" – either separately or jointly – could ever glean from the words used what was really going on with these Cash Sweep Programs: i.e., that Defendants were obtaining billions of additional dollars in profit by sweeping client cash into Defendant banks as opposed to investing the cash in safe and liquid money market***

funds; yet were paying their clients far below money market rates for Defendants' use of client cash.

Defendants Issue Deceptive Representations Of Lesser Interest On "FDIC Insured" Bank "Feature" Or "Option"

15. Thus, the "disclosures" falsely and deceptively asserted that through the Cash Sweep Programs, Defendants were acting in their clients' interest in making client cash work hard *for the client.* (Merrill Lynch ¶¶ 81-85, 87-88, 97, 107; Schwab ¶¶ 120-24, 127, 138-39, 142-43; Morgan Stanley ¶¶ 154-57, 164-65; Smith Barney ¶¶ 176-81, 189-91, 195, 200, 202-03 and Wachovia ¶¶ 208-18). Further, the cash sweep into bank accounts were touted as an FDIC-insured investment alternative to money market funds, which were not FDIC-insured. In this way, Plaintiffs' were deceptively and falsely led to believe that they were being given a lower interest bearing vehicle than a money market fund because bank deposits were "safer" than money market funds which are not FDIC-insured. In fact, and as any *bona fide* Financial Advisor knows, Plaintiffs were clearly given an inferior investment vehicle. No "Financial Advisor" would recommend to his or her clients to hold uninvested cash in an FDIC insured bank account paying less than 1% rather than in money market funds yielding 4%-5%, because money market funds are not FDIC insured and pose too great a financial risk. The detailed March 2006 IMoneyNet Report on cash sweep programs described the suggestion that "FDIC insurance" justified the paltry interest rates paid to brokerage clients swept into Defendants' low interest bank accounts as a "*sales hook*" belied by the undisclosed unblemished safety record of money market funds:

> The push to use bank products for cash sweep purposes has been bolstered by the argument that FDIC insured accounts provide safety and a higher level of comfort for some customers. ***Use of that sales hook, of course, ignores the fact that no retail investor has ever lost a penny in a modern day dollar in dollar out MMF***

[Money Market Fund], i.e. since the advent of Rule 2a -7 of the Investment Company Act of 1940 by the Securities Exchange Commission.

(Emphasis added).

Defendants Issue Deceptive Disclosures Of "Alternatives"

16. Further, Defendants falsely "disclosed" client "alternatives." (Merrill Lynch ¶¶ 103, 109, 110-11; Schwab ¶¶ 141-43; Morgan Stanley ¶ 171; and Smith Barney ¶¶ 195-200; Wachovia ¶¶ 233-34, 236, 238). These disclosures were also blatantly false and misleading since even if a client saw through the misrepresentations and knew enough to "object" and opt out of the cash sweep scheme, a client could not replace Defendants' bank accounts with higher yielding cash investments. While such higher yielding instruments could be purchased by Plaintiffs, Defendants did not permit uninvested cash to be "swept" automatically into the higher paying investment, except if the client maintained specified minimum levels of account balances. Plaintiffs would have to rely on their "Financial Advisors" – who, as noted, were financially incentivized *not* to act in their clients' interest – to review their clients' account daily and manually sweep cash into the higher yielding cash instrument. Defendants well knew it was logistically and physically impossible for their brokers, who each had hundreds of clients, to manually sweep cash into higher yielding cash investments even if their clients knew enough to instruct them to place cash in higher yielding investments. Put simply, Defendants "rigged" the system. As a result, there were, in fact, no sweep "alternatives" for Class members, other than the clients receiving no interest on their uninvested cash or leaving the firm. The true "alternatives" were of course not made plain. Either way, the clear losers were the clients and the clear winners were Defendants.

Defendants Issue Deceptive Representations Of Cash Sweep "Benefits" To Defendants; Concealed Self-Dealings Constitute Prohibited Conflicts of Interest

17. Finally, Defendants nowhere clearly and adequately disclosed the *magnitude* of Defendants' self-dealings and actual or anticipated profits from the use of their clients' uninvested cash. Such a disclosure is mandated of a "Financial Advisor" who is using client funds for its own profit, particularly where as here, there is a clear conflict of interest and the profit is the result of a financial transaction which Defendants' "Financial Advisor" devised. The calculation or quantification is easily done and was actually well in Defendants' possession, since the hundreds of millions or billion of dollars in profit were material to each Defendant's publicly reported financial results. Thus, for example, Morgan Stanley never disclosed to its clients that while it paid them as little as (currently) 1.3% interest for use of client cash, it anticipated that it would earn 8% or higher, or approximately $960 million from commercial lending or investment of the $12 billion of its deposits obtained from sweeping client cash into Morgan Stanley banks. Indeed, Defendants should have been required to obtain from each client who had funds automatically swept into Defendant banks, *inter alia*, specific written consent with full disclosure stating the client approved participation in the Cash Sweep Program, even though he understood that Defendants were obtaining average yields of 8% or higher plus fees from the use of his uninvested cash but were only paying him as little as less than 1% in interest. The quantification of the Defendants' massive profits from the use of their client cash – while charging clients and refusing to pay their clients market rates for the use of the cash – was the lynchpin nondisclosure, since if it was made the scheme would immediately collapse amid certain client recognition that their "Financial Advisors" were nothing of the sort.

18. To avoid any meaningful revelation of their massive profits, Defendants deceptively, fraudulently and selectively disclosed only *the methodology* for determining their

lending and investing profits from use of client cash. Merrill Lynch, Morgan Stanley, Smith Barney and Wachovia insufficiently describe that their "benefit" from the Cash Sweep Program will be derived from the difference between the interest paid to clients and proceeds from lending and investment of bank funds. (¶¶ 105; 173; 197, 205; 241) Schwab goes only slightly further, stating deceptively that Schwab's fees from lending and investment of client cash are "expected" to "be greater than" the bank interest paid to clients (¶ 147). It is difficult to conceive of a more misleading understatement of Defendants' multi-billion profit from the cash sweep schemes.

19. It is also no coincidence – and is only further indicia of Defendants' fraudulent intent and deceptive practices – that *the only dollar amount* Defendants "disclose" are "fees" imposed for sweeping funds into Defendants' banks. Merrill Lynch discloses it receives $65 per account from its affiliated banks (¶ 114); Schwab discloses it receives from its affiliated banks "up to 0.5% of the average daily balance" (¶ 147); Morgan Stanley discloses it receives an annual fee, payable monthly, from each sweep bank of 0.25% of the average daily deposit balances (¶ 173); Smith Barney discloses it receives a fee from each affiliated bank of up to 0.5% of the average daily deposit balance (¶ 197, 206); and Wachovia discloses it "may receive fees and compensation of up to two percent (2.0%) from Wachovia Bank and/or its affiliates" (¶ 241). By not quantifying their true massive profits and only quantifying the far less significant "fees," Defendants effectively deflect attention from the nature, size and purpose of their benefit from the sweeps scheme and conceal the deceit and fraud and gross conflict of interest from their clients. Had Defendants quantified their true massive profits from lending and investing client cash, the additional "fees" imposed on clients on top of Defendants' billions of dollars in profits

would have stood out as only further evidence of Defendants' insatiable greed and willingness, at every turn, to *put their clients last and themselves first.*

Defendants' Cash Sweep Schemes And Disclosures Violate NYSE And NASD Rules

20. Defendants' diversion of uninvested client cash from high yielding, safe and liquid money market funds into low interest bearing bank accounts at Defendants' banks blatantly violates the bedrock NASD Rule 2310, which requires that "Financial Advisors" and brokers only propose financial transactions which are "suitable" to their clients' financial objectives. (¶¶ 73-74). The Cash Sweep Programs were obviously contrary to *the clients'* investment objectives, serving instead *only those of Defendants.* Further, the Cash Sweep Programs also violated the interpretive materials governing NASD 2310 which further require Defendants engage in only "fair dealings" with customers and the public and abstain from fraudulent practices and misuse of client funds. (*Id.*).

21. Defendants' false and misleading disclosures violated fundamental NYSE and other NASD rules governing brokerage firms' conduct and disclosures. NYSE Rule 401(a), Business Conduct, states: "every member, allied member and member organization shall at all times adhere to ***the principles of good business practice in the conduct of his or its business affairs.***" (Emphasis added). Likewise, NASD Rule 2110, Standard of Commercial Honor and Principles of Trade, requires that "A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." NYSE Rule 405, "Diligence as to Account" (commonly referred to as the "Know thy customer rule"), requires that "every member organization is required ... to (1) ***Use due diligence to learn the essential facts relative to every customer***, every order, every cash or margin account ...." (Emphasis added). In addition, NYSE Rule 342.17, "Review of communications with the public", states:

"Members and member organizations must develop written policies and procedures that are appropriate for their business, their size, structure and customers in connection with the review of communications with the public relating to their business." Further, NYSE Rule 472, Communications With The Public, sub-section (i) "General Standards for All Communications", states, in pertinent part: "***No member organization shall utilize any communication which contains (i) any untrue statement or omission of a material fact or is otherwise false or misleading,*** ..." and sub-section (j), "Specific Standards for Recommendations," states in part that "[a] recommendation (even though not labeled as a recommendation) must have a basis which can be substantiated as reasonable." Similarly, NASD Rule 2210(d)(1)(A), "Communications with the Public", states: "communications with the public shall be based on principles of fair dealing and good faith ... and must provide a sound basis for evaluating the facts ...." And, pursuant to NYSE Rule 476 (Disciplinary Proceedings), "conduct or proceeding inconsistent with just and equitable principles of trade" is sanctionable by "fine, censure, suspension or bar from being associated with any member or member organization, or any other fitting sanction."

22. Further, the New York Stock Exchange, on February 15, 2005, recognizing the deceitful and misleading literature to Plaintiffs and members of the Class and Defendants' conflicts of interest, their breach of duty and care and the windfall to brokerage firms at the expense of their clients, communicated with the Defendants and suggested proper and adequate disclosures to be made in connection with the implementation of the Cash Sweep Programs and that the literature written by Defendants, ***and silence would not constitute consent.*** The guidelines were common sense disclosures necessary to make cash sweep programs not misleading to a reasonable investor, disclosing, for example, simply and concisely: 1) the extent

or "expected range of compensation" from placing their clients cash in defendant banks as opposed to in money market funds – not just the limited "fees" for sweeping the funds into defendant banks, but the 8% or higher yields defendants earned on investing or lending their clients' cash; 2) the loss to the clients in not having their cash invested in money market funds; 3) the fact that money market funds seek to increase returns to their shareholders; whereas banks do not do so and thus will pay out no more than the stated interest rate; and 4) the options available to the client both within and without the firm if the client wishes to have its cash invested in money market funds. (¶¶ 75-79). As even further evidence of Defendants' fraudulent intent, Defendants blatantly disregarded the NYSE guidelines and failed and neglected to discontinue or modify their plan and scheme to defraud. The reason was obvious: meaningful disclosures would have shattered the carefully but falsely crafted image of Defendants as "Financial Advisors" dedicated first and foremost to the financial needs and goals of their clients and thus preclude a principal means – albeit a deceptive one – for luring client funds to Defendant firms so that they could reap enormous profits.

Defendants' Cash Sweep Schemes Constitute Violations of the Investment Advisers Act and Illegal Tying Arrangements Under The Sherman Act

23. The Brokerage Defendants (defined herein at ¶53) are "Investment Advisers" under the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.*, and, as such, owed to Plaintiffs and other members of the Class a fiduciary duty to fully and fairly disclose to all conflicts of interest and all material facts, and an affirmative obligation to employ reasonable care to avoid misleading clients. For the reasons set forth herein, the Defendants also blatantly violated this obligation to promote their own self-interest, and their sweep account agreements with Plaintiffs and other members of the Class are void.

24. Further, in violation of the Sherman Act, Defendants' cash sweep schemes and programs illegally tied and coerced Plaintiffs and Class Members with lesser assets who opened *brokerage accounts* with Defendants for the primary purpose of purchasing publicly traded stocks, bonds and mutual funds to place their cash in low interest bearing *bank accounts* in Defendants' affiliated banks. Defendants used their substantial market power in the brokerage market to coerce Plaintiffs and Class Members to place their cash in artificially low interest bearing bank accounts with the anticompetitive effects of Plaintiffs being *unable* to invest their cash in accounts paying competitive interest rates and of Defendants being able to establish multibillion dollar banks using captive brokerage clients and thus incurring effectively none of the costs retail and commercial banks must incur to obtain depositors. (¶¶ 70-71, 317-323).

Public Begins To Become Aware Of Deceptive and Fraudulent Cash Sweep Schemes

25. An article in the March 6, 2006 *Investment News* entitled "Firms Squeeze Sweep Accounts for Profits," criticized Defendants' Cash Sweep Programs as "not being in the best interests of clients," as follows:

> Charles Schwab & Co. Inc. and TD Ameritrade Holding Corp. are squeezing greater profits from their default sweep accounts, and some financial advisers are criticizing the moves as not being in the best interests of clients.
>
> The opportunity to make a highly profitable change is one of the benefits of being ***a trusted household name***, according to Jon D. Holtaway, managing director of Danielson Associates Inc., a Rockville Maryland based provider of consulting services to banks.
>
> "***This is one of the reasons you spend on a brand, so you can have these profit centers that people look past,***" he said...
>
> * * *
>
> "Man, I hadn't heard that. ***It sounds like something Merrill Lynch would do to squeeze people," said a financial adviser, who asked not to be identified but whose firm manages more than $1 billion.***

> "It just means it's going to be harder to make a good return at Schwab. It's a step toward them being one of the bad guys," the adviser added.
>
> Indeed, Merrill Lynch & Co. Inc., Morgan Stanley and Smith Barney, all of New York, sweep customer cash into deposit accounts that offer paltry returns to money market funds [Investment News, December 12]. Morgan Stanley implemented the change in November. Schwab's move gives Gregory Friedman, president of Friedman & Associates, in Novato, California, who manages $195 million, some Jungian concerns.
>
> "Whenever Schwab does this kind of stuff, as an adviser, it causes a bunch of angst," he said. "I don't think it's in the customer's best interest."

(Emphasis added). Further, according to the article, regarding Schwab's ability to utilize sweep deposits through its captive bank, consultant Holtaway commented:

> ...gathering cheap capital through bank deposits can be lucrative. ***"It's eight to 10 times more profitable" than receiving the 0.74% management fee from the current money market default option***, Mr. Holtaway said. ***Schwab can lend the funds to margin account clients at prime plus 3.***

(Emphasis added). The author comments further that the risk/benefit of the business decision to adopt the cash sweep program:

> "***makes the risk of alienating customers look insignificant,***" and Mr. Holtaway added, "***Those they lose -- it'll be so profitable, it won't matter.***"

(Emphasis added).

26. Finally, on January 11, 2007, a *Wall Street Journal* article reviewed the true nature of the cash sweep program whereby "the top brokerage firms are increasingly turning cash sweeps into gold." The article noted that the enormous profits the brokerage firms were achieving by paying clients approximately 1% for use of their clients' cash and then reinvesting for "profits of roughly three to four times the fees on money funds."

II.

JURISDICTION AND VENUE

27. The claims asserted herein arise under and pursuant to alleged violations of the Investment Advisers Act of 1940, 15 U.S.C. § 80-b-1 *et seq.*, Section 349 of the New York General Business Law, breach of contract, common law breaches of fiduciary duty, fraud, negligence, unjust enrichment, negligent misrepresentation, and the anti-tying provisions of the Sherman Act, 15 U.S.C. § 1, *et seq.*

28. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. § 1332(d) (diversity). Although, Plaintiffs are citizens of New York and North Carolina, other members of the proposed Class numbering hundreds of thousands are citizens of a State different from any of the Defendants. *See* 28 U.S.C. § 1332(d)(2)(A). Additionally, the matter in controversy exceeds the sum of $5,000,000, exclusive of interests and costs. Separately, this Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. § 1331, as two of the causes of action arose from Defendants' violation of federal law, *i.e.*, the Investment Advisers Act, 15 U.S.C. 80b-14, and this civil antitrust action pursuant to 15 U.S.C. § 15(a) and 28 U.S.C. § 1337. Defendants' numerous false and misleading public filings, use of the U.S. mail system, and use of the Internet in the pursuit of their illegal plan and scheme violated federal statutes. To the extent the court has federal question jurisdiction, it also has supplemental jurisdiction over the state law claims.

29. Venue is proper in this District pursuant to 28 U.S.C. § 1391(b). Many of the acts and transactions alleged herein, including the preparation and dissemination of materially false and misleading public documents, disclosure statements, brochures and other information, occurred in this District. These acts and transactions included the preparation and issuance of

written communications by Defendants to investors concerning their sweeps of available monies in their brokerage accounts. Additionally, eight of the twenty-one Defendants maintain their principal executive offices in this District, and all of the Defendants are subject to personal jurisdiction in this District. Venue is also proper in this District pursuant to 15 U.S.C. § 15(a). Each of the Defendants resides, is found, transacts business, or has an agent in this District. Further, venue is proper in this District pursuant to 15 U.S.C. § 80b-14.

III.

PARTIES

30. Plaintiff Carlo DeBlasio resides in New York State, Greene County, and maintains a brokerage account with Defendant Smith Barney. Carlo DeBlasio's uninvested cash balances were swept pursuant to Smith Barney's Bank Deposit Program. As of March 31, 2007, Mr. Deblasio was receiving only 1.41% interest on uninvested cash awaiting investment.

31. Plaintiff Ronald Kassover resides in New York State, Nassau County, and maintains brokerage accounts with Defendants Merrill Lynch, Smith Barney and Morgan Stanley. Ronald Kassover's uninvested cash balances were swept pursuant to Merrill Lynch's Bank Deposit Program, Smith Barney's Bank Deposit Program and Morgan Stanley's Bank Deposit Program, and received interest on uninvested cash awaiting investment. As of December 31, 2006, Mr. Kassover received the following rates of interest on uninvested cash at Merrill Lynch – 3.20%, Smith Barney – 3.24%, and Morgan Stanley – 3.20%.

32. Plaintiff Jerome Silverman resides in New York State, Nassau County, and maintains a brokerage account with Defendant Merrill Lynch. Jerome Silverman's uninvested cash balances were swept pursuant Merrill Lynch's Bank Deposit Program. As of January 31, 2007, Mr. Silverman was receiving interest of 1.45% on uninvested cash awaiting investment.

33. Plaintiff Deborah Torres resides in New York State, Westchester County, and maintains a brokerage account with Defendant Schwab. Deborah Torres' uninvested cash balances were swept pursuant to Schwab's Bank Sweep Feature. As of March 31, 2007, Ms. Torres was receiving interest of 2.55% interest on uninvested cash awaiting investment.

34. Plaintiff Michael R. Schirripa resides in New York State, Richmond County, and maintains a brokerage account with Defendant Schwab. Michael Schirripa's uninvested cash balances were swept pursuant to "The Schwab One Interest Feature." As of March 31, 2007, Mr. Schirripa was receiving interest of 0.965% on uninvested cash awaiting investment. On or about May 1, 2007, Schwab phased out its Schwab One Interest feature so that Michael Schirripa is now subject to the bank deposit program.

35. Plaintiff Arthur Kornblit resides in New York State, Nassau County, and maintains a brokerage account with Defendant Morgan Stanley. Arthur Kornblit's uninvested cash balances were swept pursuant to Morgan Stanley's Bank Deposit Program. As of March 31, 2007, Mr. Kornblit was receiving interest of 1.25% on uninvested cash awaiting investment.

36. Plaintiff Carol Washburn resides in North Carolina, Mecklenburg County. Until approximately February 2006, Ms. Washburn maintained a brokerage account with Defendant Wachovia. Ms. Washburn's uninvested cash balances were swept pursuant to Wachovia's Bank Sweep Program. As of February 28, 2006, Ms. Washburn received interest of 3.29% on uninvested cash awaiting investment.

37. The plaintiffs set forth in the paragraphs 30-36 are hereinafter collectively referred to as the "Plaintiffs."

38. Defendant Merrill Lynch & Co., Inc. ("ML&Co.") is a Delaware corporation with its principal executive offices located at World Financial Center, North Tower, 250 Vesey Street, New York, NY 10080.

39. Defendant Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S") is a Delaware Corporation with its principal executive offices located World Financial Center, North Tower, 250 Vesey Street, New York, NY 10080. MLPF&S is a wholly-owned subsidiary of ML&Co. and is a registered broker-dealer. (MLPF&S and ML&Co. are collectively referred to as "Merrill Lynch").

40. Defendants (a) Merrill Lynch Bank, USA, a Utah chartered bank, located at 15 West South Temple, Suite 300, Salt Lake City, Utah 84101; and (b) Merrill Lynch Bank & Trust Co., FSB, located at 4 World Financial Center, New York, New York 10080, are Merrill Lynch's sweep banks ("Merrill Lynch Sweep Banks"). The Merrill Lynch Sweep Banks are wholly owned subsidiaries of ML&Co. ML&Co. controlled and directed the actions of MLPF&S and the Merrill Lynch Sweep Banks as agents in executing the fraudulent and deceptive cash sweep scheme and was also a principal financial beneficiary from the profits obtained from the execution of said scheme, including obtaining profits from lending and investing Plaintiffs' and other members of the Class' uninvested cash swept into the Merrill Lynch Sweep Banks.

41. Defendant Morgan Stanley ("MS") is a Delaware corporation with its principal executive offices located at 1585 Broadway, New York, NY 10036.

42. Defendant Morgan Stanley & Co. Inc. ("MS&Co.") is a Delaware corporation with its principal executive offices located at 1585 Broadway, New York, NY 10036. MS&Co. is a wholly-owned subsidiary of MS. MS&Co. is the successor to of Morgan Stanley DW, Inc. ("MSDW") pursuant to an April 1, 2007 merger, in which MSDW was merged into MS&Co.

(MS, MS&Co. and MSDW are collectively referred to as "Morgan Stanley"). Prior to the merger, MSDW was Morgan Stanley's principal registered broker-dealer, and on completion of the merger, the surviving entity, MS&Co. became Morgan Stanley's principal registered broker-dealer.

43. Defendants (a) Morgan Stanley Bank, a Utah chartered industrial bank, located at 2500 Lake Park Blvd., Suite 3C, West Valley, Utah 84120; and (b) Discover Bank, a Delaware chartered bank, located at 502 E. Market Street, Greenwood, Delaware 19950, are Morgan Stanley's sweep banks ("Morgan Stanley Sweep Banks"). The Morgan Stanley Sweep Banks are wholly owned subsidiaries of MS. MS controlled and directed the actions of MS&Co. and the Morgan Stanley Sweep Banks as agents in executing the fraudulent and deceptive cash sweep scheme and was also a principal financial beneficiary from the profits obtained from the execution of said scheme, including obtaining profits from lending and investing Plaintiffs' and other members of the Class' uninvested cash swept into the Morgan Stanley Sweep Banks.

44. Defendant Citigroup, Inc. ("Citigroup") is a Delaware corporation with its principal offices at 399 Park Avenue, New York, NY 10043. Citigroup is a global, full-service financial firm that provides brokerage, investment banking and asset management services to its clients.

45. Defendant Citigroup Global Capital Markets Inc. ("CGCM") is a wholly owned indirect subsidiary of Citigroup and was formerly known as Salomon Smith Barney, Inc. CGCM's principal executive office is located at 388 Greenwich Street, New York, New York 10013. CGCM is a registered broker-dealer and conducts its brokerage business under the name of Smith Barney. (Citigroup and CGCM are collectively referred to as "Smith Barney").

46. Defendant (a) Citibank N.A., a nationally chartered bank located at 399 Park Avenue, New York, New York 10043; (b) Citicorp Trust Bank, FSB, a Delaware chartered bank, located at 4500 New Linden Hill Road, Wilmington, Delaware 19808, and (c) Citibank (South Dakota) N.A., a nationally chartered bank located at 701 60th Street North, Sioux Falls, South Dakota 57117, are Smith Barney's sweep banks ("Smith Barney Sweep Banks"). The Smith Barney Sweep Banks are wholly owned subsidiaries of Citigroup. Citigroup controlled and directed the actions of CGCM and the Smith Barney Sweep Banks as agents in executing the fraudulent and deceptive cash sweep scheme and was also a principal financial beneficiary from the profits obtained from the execution of said scheme, including obtaining profits from lending and investing Plaintiffs' and other members of the Class' uninvested cash swept into the Smith Barney Sweep Banks.

47. Defendant The Charles Schwab Corporation ("Charles Schwab") is a Delaware Corporation with its principal executive offices located at 101 Montgomery Street, San Francisco, CA 94104, and maintains an executive and sales office in New York.

48. Defendant Charles Schwab & Co., Inc. ("CS&Co.") is a California corporation with its principal executive offices located at 101 Montgomery Street, San Francisco, CA 94104. CS&Co. is a wholly-owned subsidiary of Schwab Holdings, Inc. ("Schwab Holdings"), which in turn, is a wholly-owned subsidiary of Charles Schwab. CS&Co is a registered broker-dealer. (Charles Schwab and CS& Co. are collectively referred to as "Schwab".)

49. Defendants (a) Charles Schwab Bank, N.A., a nationally chartered bank located at 5190 Neil Road, Suite 300, Reno, Nevada 89502; and (b) U.S. Trust Company, N.A., a nationally chartered bank located at 515 South Flower Street, Suite 2700, Los Angeles, California 90071, are Charles Schwab's sweep banks ("Schwab Sweep Banks"). The Charles

Schwab Sweep Banks are wholly owned subsidiaries of Charles Schwab. Charles Schwab controlled and directed the actions of CS&Co. and the Charles Schwab Sweep Banks as agents in executing the fraudulent and deceptive cash sweep scheme and was also a principal financial beneficiary from the profits obtained from the execution of said scheme, including obtaining profits from lending and investing Plaintiffs' and other members of the Class' uninvested cash swept into the Charles Schwab Sweep Banks.

50. Defendant Wachovia Corporation ("Wachovia Corp.") is a North Carolina corporation with its principal executive offices located at 301 South College Street, Suite 4000, One Wachovia Center, Charlotte, North Carolina 28288, and maintains an executive and sales office in New York. Wachovia Corp. was formed on September 1, 2001 by the merger of the former Wachovia Corporation and First Union Corporation. As reported in The Wall Street Journal, on June 1, 2007, Wachovia Corp. announced its acquisition of A.G. Edwards Inc. for $6.95 billion making it "one of the country's biggest brokerage houses." Wachovia indicated in the same Wall Street Journal article that it plans to introduce its cash sweep program to A.G. Edwards' clients to "boost the [A.G.] Edwards brokers' productivity ... by shifting more client cash from money-market funds into its own insured bank accounts, ***where customers often get low rates but Wachovia can reinvest the funds more profitably***." (Emphasis added.)

51. Defendant Wachovia Securities, LLC ("Wachovia Securities") is a Delaware limited liability company with its principal executive offices located at Riverfront Plaza, 901 E. Byrd St., Richmond, Virginia 23219-4069. Wachovia Securities is a wholly-owned subsidiary of Wachovia Financial Holdings, LLC (Wachovia Financial Holdings") and is a registered broker-dealer. Wachovia Financial Holdings is a joint venture between Wachovia Corp. and Prudential Financial Inc., with Wachovia Corp. holding a controlling 62 percent interest and appointing

three members to Wachovia Financial Holdings' five-member Board of Managers. As reported on Wachovia's website, Wachovia Securities is the nation's third largest brokerage firm when measured in total client assets. Defendants Wachovia Corp. and Wachovia Securities are collectively referred to as "Wachovia."

52. Defendants (a) Wachovia Bank N.A., a nationally chartered bank located at 301 South Tyron Street, Charlotte, North Carolina 28288; and (b) Wachovia Bank of Delaware, N.A., a nationally chartered bank located at 100 W. 10th Street, Wilmington, Delaware 19801, are Wachovia's sweep banks ("Wachovia Sweep Banks"). The Wachovia Sweep Banks are wholly owned subsidiaries of Wachovia Corp. Wachovia Corp. controlled and directed the actions of Wachovia Securities and the Wachovia Sweep Banks as agents in executing the fraudulent and deceptive cash sweep scheme and was also a principal financial beneficiary from the profits obtained from the execution of said scheme, including obtaining profits from lending and investing Plaintiffs' and other members of the Class' uninvested cash swept into the Wachovia Sweep Banks.

53. Defendants MLPF&S, MS&Co., CGCM, CS&Co. and Wachovia Securities are collectively referred to as the "Brokerage Defendants." Defendants ML&Co., MS, Citigroup, Charles Schwab and Wachovia Corp. are collectively referred to as the "Parent Corporation Defendants." The Merrill Lynch Sweep Banks, the Morgan Stanley Sweep Banks, the Schwab Sweep Banks, the Smith Barney Sweep Banks and the Wachovia Sweep Banks are collectively referred to as the "Sweep Bank Defendants."

IV.

PLAINTIFFS' CLASS ACTION ALLEGATIONS

54. Plaintiffs bring this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and 23(b)(3) on behalf of a class, consisting of all those who maintained a brokerage account with one or more of the Brokerage Defendants where the clients' uninvested cash was automatically swept into a Defendant controlled and affiliated bank account paying interest below prevailing money market yields. Excluded from the Class are Defendants, their officers and directors at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which the Defendants have or had a controlling interest.

55. The members of the Class are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown to Plaintiffs at this time and can only be ascertained through appropriate discovery, Plaintiffs believe that there are many thousands of Class members. Class members may be identified from records maintained by Defendants.

56. Plaintiffs' claims are typical of the claims of the Class, as all Class members were and are similarly affected by Defendants' wrongful conduct in violations of the Investment Advisers Act of 1940, the GBL, the Sherman Act and common laws that are complained of herein. Plaintiffs and each of the Class members entered into uniform contracts to open a brokerage account, received uniform disclosures, and maintained cash balances with one or more of the Defendants. Defendants' tiering tactics and cash sweeping practices were suppressed and concealed from the Class by Defendants, which made affirmative misrepresentations throughout the Class Period such as that the Plaintiffs and Class were getting rates among the most

competitive in the industry. Plaintiffs and the other Class members have sustained monetary damages resulting from Defendants' deceitful and improper practices.

57. Plaintiffs will fairly and adequately represent and protect the interests of the other Class members and have retained counsel competent and experienced in class action litigation.

58. Common questions of law and fact exist as to all Class members and predominate over any questions solely affecting individual Class members. Among the questions of law and fact common to the Class are:

(a) whether the GBL was violated by Defendants' deceitful and improper conduct as alleged herein;

(b) whether Defendants engaged in breaches of fiduciary duty, self-dealings, prohibited conflicts of interest, unjustly enriched by their conduct;

(c) whether Defendants' conduct complained of herein constituted a breach of contract;

(d) whether Defendants' committed negligence, fraud, negligent misrepresentations, and whether statements made by Defendants to Plaintiffs and other members of the Class members in their brokerage agreements, account statements, mailings, web pages and brochures during the Class Period were materially false and misleading and misrepresented material facts in that the bank deposits were more profitable to Defendants but not to the customers, who could have received higher rates through other alternatives such as the money market funds;

(e) whether Defendants breached their fiduciary duties to Plaintiffs and the other Class members by failing to fully disclose the alternatives to bank deposits available to the

customers and that Defendants engaged in self-dealings whereby they reaped huge profits by reinvesting the customers' cash into the less interest paying bank deposit accounts;

(f) whether Defendants had a duty to disclose material facts concerning their cash sweeping and tiering practices;

(g) whether Defendants violated the Investment Advisers Act, 15 U.S.C. § 80b-1 *et seq.*;

(h) whether Defendants violated the Sherman Antitrust Act, 15 U.S.C. § 1;

(i) whether Defendants' bank sweep contracts with Plaintiffs and other members of the Class should be voided;

(j) to what extent the Class has sustained damages; and

(k) to what extent Defendants were unjustly benefited by and should be held to account for their wrongful conduct, and should be directed to disgorge profits.

59. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. As the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

60. Each of the Class members maintains or maintained a brokerage account with one or more of the Brokerage Defendants and has or had an uninvested cash balance swept into bank accounts.

VI.

SUBSTANTIVE ALLEGATIONS

A. Background

1. Prior to Changes, Defendants Swept Clients' Uninvested Cash Invested In Money Market Funds Currently Yielding 4%-5%

61. Money markets funds have been in existence for 35 years and have come to represent an excellent means for investors to hold cash safely while at the same time obtaining higher yields than available in checking or savings accounts. As noted, currently Americans hold over $3.2 trillion in money market funds.

62. A money market fund is an open-ended investment company that invests in safe, short term debt instruments such as U.S. Treasury, federal agency or high-quality corporate securities, and that seeks to maintain a stable price of $1 per share, while providing a competitive rate of current income. Money market funds are also liquid, meaning an investor can withdraw funds from them on short notice. There is typically no penalty for taking money out of a money market fund – unlike for Certificates of Deposit (CDs), for which substantial early withdrawal fees are charged. Also, money market funds are very low risk investments. While not insured by the FDIC, money market funds hold safe investments such as treasury bills or highly-rated short-term corporate commercial paper. It has been highly unlikely to lose principal in a money market fund.

63. Money market yields are generally higher than checking and savings accounts. Taxable money market funds currently return 4 to 5 percent, which rivals the return of CDs. Money market fund interest is generally calculated daily but is only paid out at the end of the month unless an investor sells an interest in the fund, when it is paid at that time. As a result,

money market funds proved to be the most safe and profitable vehicle for holding uninvested cash.

2. As Money Market Yields Begin To Increase Significantly Defendants Look To Cash In On Clients' Uninvested Cash

64. Beginning in 1977, Merrill Lynch pioneered the concept of a Cash Management Account ("CMA") – an account that combined the features of a typical brokerage account with "sweeps" of uninvested moneys into money market funds and the ability to write checks from those funds along with other bank-like features. This concept was widely adopted by the brokerage industry, and each of the Defendants has long offered brokerage accounts including cash sweep features.

65. Until the late 1990s, uninvested monies in these accounts were swept into money market funds so customers would receive the benefit of money market rates while also maintaining the cash proceeds in safe and highly liquid investments. However, the profits obtained by Defendants from money market "sweep account" features were limited in nature. Money market funds typically charge an annual "expense ratio" that is generally small – less than 1% of principal. For example, the expense ratio of Vanguard's Prime Money Market Fund was 0.29% as of June 2006, and the expense ratios for Schwab's money market sweep funds (available only to high net-worth customers) are currently 0.75% or lower. Also, since money market funds are maintained in a trust, those funds were ***unavailable*** for use by a brokerage firm to lend or to invest in higher-yielding activities in order to generate a substantial profit on the spread.

66. In late 1997, Smith Barney, and in March 2000, Merrill Lynch, began to provide for sweeps into bank accounts at bank affiliates. Subsequently, Schwab in October 2003, Wachovia in the fourth quarter of 2004 and Morgan Stanley in November 2005 also provided for

sweeps into bank affiliates. With the exception of Morgan Stanley, each of these Defendants initially paid interest rates that were competitive to the sweep account money market rates that were previously provided to their customers. However, once these accounts were established, it became irresistible to the Defendants to pay ***substantially lower*** rates from their captive banks and to ***restrict*** access to alternative money market sweep accounts – at least to their less wealthy customers. In this way, Defendants could pocket the spread between the low rates they paid on the tiered bank sweep deposits and the substantially higher returns or rates that could be generated by their deployment of sweep account monies from their own banks' accounts.

67. In June 2001, Merrill Lynch was the first of the Defendants to introduce a "tiered" bank sweep account, in which lower interest rates were paid to less wealthy customers – at a time when the "federal funds" rate was 4%. Once interest rates recovered after declining to below 1% in mid-2003, Schwab and Morgan Stanley implemented their own tiered program in 2005, and Wachovia and Smith Barney implemented their tiered programs in 2006. Also, in order to grab further profits, Merrill Lynch in 2005 ***precluded*** its customers with less than $250,000 in assets from electing a sweep money market account; Schwab in January 2006 ***precluded*** customers with less than $500,000 in assets from using money market accounts as a sweep option; Smith Barney in March 2006 ***precluded*** customers with less than $250,000 from using tax-free money market funds (the other available sweep alternatives) for new funds, with the tax-free sweep monies funds to be depleted first in order to cover debits in the customers' brokerage accounts; and Wachovia ***precludes*** customers except those having a "Command Asset" account from electing a money market sweep alternative.

3. Defendants Reap Enormous Profits From Sweeping Clients' Cash Into Affiliated Banks

68. In 2006 alone Merrill Lynch was expected to record over $2 billion in profit just from the ***taking for itself*** of interest on client cash previously earned by its clients. Also, Morgan Stanley, in its Form 10-Q for the quarter ended February 28, 2007, stated that "[n]et revenues increased 18% from last year's first quarter to $1,490 million, reflecting higher transactional revenues due to increased underwriting activity, higher asset management revenues reflecting growth in fee-based products ***and higher net interest revenue from the bank deposit sweep program***." (Emphasis added). In CS&Co.'s financial statements for the year ended December 31, 2006, Schwab disclosed that sweep bank account deposits totaled $10.7 billion. And, in Wachovia's year-end 2004 and 2005 Form 10-K's disclosed that its bank sweep deposits were $29.9 billion at December 31, 2004 and increased by $17.6 billion during 2005 (*i.e.*, a total of $47.5 billion). Also, according to a January 11, 2006 *Wall Street Journal* article, Smith Barney adopted a tiered rate structure in the past year because "the firm decided ***it couldn't afford to pass up the profits*** and risk being left at a competitive disadvantage...." (Emphasis added).

4. Defendants' Deceptive Cash Sweep Created For Defendants' Multi-Billion Dollar "Cost Free" Banks Filled With Captive Brokerage Depositors

69. Defendants' ability to generate massive profits arose both from the ability to lend and invest client cash at 8% or higher and from the fact that they were essentially able to create multibillion dollar banks – filled with captive brokerage client depositors – *without* any of the costs normally associated with commercial banking. The "efficiency ratio" is a banking industry metric that assesses the financial performance of a particular financial intermediary. This ratio is generally defined as the ratio of noninterest expense to revenue, net of interest expense, plus

recurring noninterest income. Efficiency ratios of well performing institutions are generally in the 60% range. All things being equal, a lower efficiency ration indicates more favorable performance by the financial institution. Based on an analysis of Defendants' Form 10-K filings for the year-ended December 31, 2006 (and November 30, 2006 for Morgan Stanley banks), Call Reports filed quarterly with the FDIC and Thrift Financial Reports filed quarterly with the Office of Thrift Supervision, it is not surprising that the efficiency ratios of Defendants' banks are in the 20% range or above, indicating optimal efficiency. For example, the efficiency ratio as of December 31, 2006 for: Schwab Bank was 22.9%; Citibank (South Dakota) was 51.68%; Citi Trust was 22.55%; Merrill Lynch Bank USA was 25.89%; Wachovia Bank, N.A. was 59%; Wachovia Bank of Delaware was 19.1%; and notably, Morgan Stanley Bank had an astonishing efficiency ratio of 4.4%.

5. Defendants Divert $186.25 Billion Of Client Cash From Money Market Funds Or Accounts Paying Money Market Rates To Defendant Banks

70. Defendants' deceptive cash sweep programs resulted in an enormous shift of client cash into defendant banks. As reported in Defendants Merrill Lynch's Form 10-K for the year-ended December 29, 2006, Charles Schwab's Form 10-K for the year-ended December 31, 2006, Morgan Stanley's Form 10-K filings for the year-ended November 30, 2006, and Smith Barney's Form 10-K for the year-ended December 31, 2004; and Wachovia's Form 10-K for the year ended December 31, 2004 and 2005, Defendants ***swept over $186 billion*** into affiliate banks:

Defendant	Total Bank Deposits Attributable to Sweep Program[1]
Merrill Lynch	$62.3 Billion
Charles Schwab	$10.65 Billion
Morgan Stanley	$13.3 Billion
Smith Barney	$43 Billion
Wachovia	$47.5 Billion
Total:	**$186.25 Billion**

71. This amount represented a material portion of cash being swept from money market funds into brokerage firm banks. According to the *America's Intelligence Wire*, on November 22, 2004:

> Money market funds are losing ground to federally insured brokerage sweep accounts, where assets now top $350 billion, a study released Monday said. The bank sweep account assets, which unlike those in money market funds are insured by the Federal Deposit Insurance Corporation, have grown more than 53% annually since 2000, and could exceed $400 billion within the next year, the study said.
>
> The accounts have lured $250 billion away from money market funds, while another $150 billion of new money has moved into the new money bank accounts instead of going into money funds, according to iMoneyNet, which conducted the study.
>
> "Broker sold, FDIC insured cash sweep accounts are the biggest trend in cash investing since the invention of the money market fund in 1971," said Peter Crane vice president and managing editor of iMoneyNet, publisher of the Money Fund Report, in a Statement.

6. Defendants' Cash Sweep Programs Blatantly Violated NASD Requirement That Financial Advisors Proposed Transactions Be "Suitable"

72. Defendants' Cash Sweep Programs violated the most basic NASD requirement that the financial transactions proposed by "Financial Advisors" to their clients be "***suitable***" meaning that they met the "***customers' financial objectives.***" The Cash Sweep Programs by

[1] Smith Barney's and Wachovia's data are from Smith Barney's Form 10-K filings for the year-ended December 31, 2004 and from Wachovia's Form 10-K filings for the years ended December 31, 2004 and December 31, 2005. These amounts currently may be significantly higher, but they are not clearly disclosed in Smith Barney's or Wachovia's subsequent Form 10-Ks.

diverting client cash from high yielding, safe and liquid money market funds into low interest-bearing bank accounts were clearly "unsuitable" transactions which served to meet only defendants' financial objectives at their clients' expense.

73. The NASD has also promulgated "suitability" rules governing a broker's relationship with its customers. NASD Rule 2310 provides, *inter alia*, as follows:

> **2310. Recommendations to Customers (Suitability)**
>
> (a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.
>
> (b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning:
>
> (1) the customer's financial status;
>
> (2) the customer's tax status;
>
> (3) ***the customer's investment objectives; and***
>
> (4) ***such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.***

(Emphasis added).

74. Defendants' Cash Sweep Programs also violated NASD Interpretative Materials for Rule 2310, which mandate "fair dealing," with the public including the requirement to not issue fraudulent misrepresentations and omissions in connection with financial transactions:

> **IM-2310-2. Fair Dealing with Customers**
>
> (a)(1) ***implicit in all member and registered representative relationships with customers and others is the fundamental responsibility for fair dealing.*** Sales efforts must therefore be undertaken only on a basis that can be judged as being

within the ethical standards of the Association's Rules, with ***particular emphasis on the requirement to deal fairly with the public.***

(2) this does not mean that legitimate sales efforts in the securities business are to be discouraged by requirements which do not take into account the variety of circumstances which can enter into the member-customer relationship. ***It does mean, however, that sales efforts must be judged on the basis of whether they can be reasonably said to represent fair treatment for the persons to whom the sales efforts are directed,*** rather than on the argument that they result in profits to customers.

(b) District Business Conduct Committees and the Board of Governors have interpreted the Rules, taken disciplinary action and imposed penalties in many situations where members' sales efforts have exceeded the reasonable grounds of fair dealing. ***Some practices that have resulted in disciplinary action and that clearly violate this responsibility for fair dealing are set forth below, as a guide to members***:

* * *

(4) Fraudulent Activity

(A) Numerous instances of fraudulent conduct have been acted upon by the Association and have resulted in penalties against members. Among some of these activities are:

* * *

ii) Discretionary Accounts

Transactions in discretionary accounts in excess of or without actual authority from customers.

(iii) Unauthorized Transactions

Causing the execution of transactions which are unauthorized by customers ***or the sending of confirmations in order to cause customers to accept transactions not actually agreed upon.***

(iv) Misuse of Customers' Funds or Securities
Unauthorized use or borrowing of customers' funds or securities.

(B) ***In addition, other fraudulent activities, such as forgery, non-disclosure or misstatement of material facts, manipulations and various deceptions***, have been found in violation of Association Rules. These same activities are also subject to the

civil and criminal laws and sanctions of federal and state governments.

(Emphasis added).

7. Defendants Disregard New York Stock Exchange Guidelines For Sweep Disclosures

75. On February 15, 2005, the NYSE issued Information Memo (Number 05-11) stating concerns about brokerage firm's adaptation of sweep accounts, noting that, "[i]n some cases, however, cash sweep account programs at member organizations may have been instituted or changed without fully appropriate levels of disclosure and customer consent." As stated in the August 1, 2005 *Los Angeles Times*:

> The move to bank deposits has caught the attention of regulators at the New York Stock Exchange, ***who are worried that brokerages may not be properly disclosing the account shifts to customers and may in some cases be stuffing them into unfairly low-yielding accounts***. In a warning to firms in February, the NYSE told them to mail clearly worded disclosures to customers about bank-sweep programs.
>
> "***In some instances, you've got to read through 40 pages of paper, and the print can be very small***," said Grace Vogel, NYSE executive vice president of member firm regulation.

(Emphasis added).

76. The Information Memo first noted that where a client's funds are moving from a higher yielding money market to a lower yielding bank account, it may well be inappropriate for the firm to merely rely upon disclosure as opposed to obtaining the client's specific consent:

> **DISADVANTAGEOUS CHANGES IN THE RATE STRUCTURE**
>
> The Exchange will review each new program and/or change to an existing program individually, and would expect that any customer agreement being used as a basis for prior or negative consent provides the customer with notice of the process by which the agreement could be amended, together with effective contemporary or subsequent disclosure, in order to justify such consent(s). ***Where the interest rate to be paid by the bank is materially less than the rate currently paid by the customer's prior money market mutual fund account;***

> ***where the bank rate is a temporary promotional rate; or where the member organization's business model or known plans propose lowering the rate, whether in real terms or as against market rates, prior or negative consent may not be adequate***

(Emphasis added).

77. The NYSE Information Memo also indicated that the sweep disclosure needed to be done at a number of different times: when the change was made; when new accounts were opened; and when changes were made to the sweep program after the program was implemented:

> **CUSTOMER DISCLOSURES**
>
> As discussed more fully below, member organizations must disclose the terms and conditions, risks and features of their programs, conflicts of interest, current interest rates, the manner by which future interest rates will be determined, as well as the nature and extent of SIPC or FDIC insurance available. In addition, customers should be advised of which entity to contact should they wish to gain access to their funds. ***All such disclosures should be forthright, clear, complete, prominent and unambiguous.*** Given the complicated nature of these disclosures, these points should also be summarized in a concise document, preferably on one or two pages, written in plain English and referring customers to places where additional and more detailed disclosure is available. These disclosures should be made: (1) at the time when such programs are first implemented by the member organization, (2) at the opening of new accounts, and (3) as changes are made to an existing program.

(Emphasis added.)

78. Finally the NYSE also indicated the nature of the specific disclosure which should be made, including the "expected range" of the firm's profit or "compensation and other benefits for customer balances maintained at the bank;" that bank rates may be "inconsistent with" the clients' "reasonable expectation of money market rates;" and that banks as opposed to money market funds are not obligated to provide the highest yields:

> **CONFLICTS OF INTEREST**
>
> Rule 472(i) ("General Standards For All Communications") provides, in pertinent part: "No member or member organization shall utilize any communication which contains (i) any untrue statement or omission of a material fact or is otherwise false or misleading". Member organizations therefore must include in their

> agreements or disclosure documents any conflicts of interest in connection with the cash sweep program, including ***whether the member organization receives compensation or other benefits for customer balances maintained at the bank, and if so the expected range of such compensation, as well as a disclosure of the difference, if any, between the rates of return at the existing money market fund and the proposed bank sweep fund. A change from a money market mutual fund to a bank sweep fund may be inconsistent with the customer's reasonable expectations with regard to money market rates.*** While a registered investment company, such as a money market mutual fund, is bound by fiduciary obligations to its shareholders (customers of the member organization) to seek the highest rates prudently available (less disclosed fees and expenses), ***when customer funds are swept to an affiliated bank it is in the interest of the member organization and its affiliates to pay as low a rate as possible***, consistent with their views of competitive necessities. There may be no necessary linkage with rates prevailing in the market, and these funds are not being managed, in this instance, under the same fiduciary obligations.

(Emphasis added).

79. The NYSE's Information Memo was followed on April 2005 by a speech given by Richard Ketchum, then the head of the NYSE's regulatory unit, which even more clearly set forth the kind of specific disclosures needed to apprise clients of the adverse impact on the clients and enormous gain for the Defendant firms that the sweep program posed:

> An equally important part of your firm's control program must be to proactively consider the effectiveness of your investor disclosures as you make changes that directly impact your customers.
>
> Two examples can illustrate this point. ***First, many larger firms have attempted to capitalize on the firm's affiliation with a banking operation to begin sweeping customers' free credit balances to that bank as opposed to money market funds. Done correctly, this may make sense for all parties, but the conflicts are clear. We have recently put out a notice to our member firms to emphasize the importance of clear and direct disclosure here. Does the customer understand the alternatives they have within and outside the firm? Are relevant money market rates rules made easily accessible and explained? Are payments made by the affiliated firm to the brokerage effectively disclosed? Finally, are the rates comparable to money market alternatives? If not we have serious concerns with the movement of customers' funds without their affirmative consent.***

> This is an area where we have tried to put out our views to the industry, after consultation and without new rules or enforcement actions. But this direction will only continue if the industry response is commensurate.

(Emphasis added).

80. Needless to say, Defendants' disclosures failed to comply either with the Information Memorandum or Ketchum's speech on the same subject. As is demonstrated below, the disclosures were buried and in piles of paper and achieved their purpose of obfuscating Defendants' massive profits at their clients' expense.

B. Defendants' Deceptive, False And Misleading Disclosures

1. Merrill Lynch's Deceptive "Clients Come First" Disclosures

81. Merrill Lynch presented to its clients on its website a "Client Commitment" statement which provides in no uncertain terms that the client is Merrill Lynch's first priority is as follows:

> ***Our most deeply held principle at Merrill Lynch is clients come first.*** We are proud to be part of that tradition. To help you meet your financial objectives and build your wealth, we offer advice that goes beyond stocks and bonds to look at your complete financial picture – advice that adds value to your life, not just your balance sheet. ***At Merrill Lynch, we provide powerful resources, from investment strategies to state-of-the-art technology, to help our clients Achieve Life. Let us put them to work for you.***

(Emphasis added).

82. Merrill Lynch further stated that its "Financial Advisors" function as their clients' partners," looking out for what was in their clients' best interests:

> **Achieve Life on Your Terms**
>
> ***Our Financial Advisors take the time to understand what matters to you. By acting as your partner,*** they look beyond investments, drawing upon their knowledge of you and the expertise and financial resources of Merrill Lynch to deliver the right solution at the right moment. That's Total Merrill[SM]
>
> * * *

> Find a Financial Advisor and learn how Total Merrill can help you achieve the life you want.

(Emphasis added).

83. Merrill Lynch described on its "get started today" web page how its "Financial Advisors," through "Total Merrill," "consider all the pieces of your financial life":

> ***A Merrill Lynch Financial Advisor*** can help you achieve life by becoming a ***valuable partner, an expert in you, someone who knows you and what matters to you.*** For that, we need to ask the right questions, listen to your answers and ***consider all the pieces of your financial life.*** That's Total Merrill.

(Emphasis added).

84. Merrill Lynch then describes how its "Total Merrill" program is implemented through a four step "proven process" in or order "to ensure your unique needs are understood" and are matched with an "optimal" mix of investment products:

> **Merrill Lynch Wealth Management Process**
>
> All wealth is personal. Our Financial Advisors can provide you access ***to a proven process with a suite of robust tools to ensure that your unique needs are understood***, and build on that foundation over time.

(Emphasis added).

85. Merrill Lynch's misrepresentations to Plaintiffs and other members of the Class that Merrill Lynch Financial Advisors have a special relationship of trust and loyalty to their clients such that the client comes first were repeated hundreds of time in print, television and other media.

86. The statement in paragraphs 80-85, *supra*, were deceptively false and misleading because, *inter alia*, the cash sweep program ensured Merrill Lynch clients were put "*second*" after Merrill Lynch's profit; Merrill Lynch did not act in the sweep program as a "valuable partner" of its clients but rather as a competitor using client cash for its own profit; nor were

Merrill Lynch resources and tools used to address clients' financial interests in the sweep program.

87. Merrill Lynch has also issued ethical guidelines. Merrill Lynch's October 2005 Guidelines for Business Conduct, which are available from Merrill Lynch's web site, state, in part, that:

> Every Merrill Lynch person must deal fairly with Merrill Lynch's clients, vendors, competitors and fellow employees. No Merrill Lynch person may take advantage of anyone through unethical or illegal measures, such as manipulation, concealment, abuse of privileged information, misrepresentation of material facts or any other unfair dealing practices...

88. Merrill Lynch has also issued a "Commitment to Clarity," including an "Investors' Bill of Rights" and a section (based on a Securities Industry Association 2004 statement) listing "Your Rights as an Investor." Among the statements are the following:

> Merrill Lynch believes that strong, open and well-regulated securities markets are fundamental to America's overall economic well-being and the creation of wealth. Markets depend upon investor trust. Without trust, markets cannot efficiently function. The cornerstone of investor trust is clarity about the rewards and also the risks that markets offer.
>
> * * *
>
> ***We are committed to clarity through full and unambiguous disclosure, as well as enhanced understanding of the securities markets.***
>
> ***We believe that the needs of the investor should always come first. As an investor, you have important rights, including the right to high-quality products and services form the securities firm you choose.***
>
> * * *
>
> **YOUR RIGHTS AS AN INVESTOR**
>
> *As an investor, you have the right to:*
>
> **Quality Service**
>
> ▪ ***To be treated in a fair, ethical and respectful manner in all interactions with a securities firm, its employees and its affiliates.***

* * *

Full, Clear Reporting

- To receive clear, accurate, easy-to-understand descriptions of all your transactions, statements and other communications from your investment firm.

- ***To be informed clearly about all the costs associated with your account and the costs related to individual transactions, including commissions, sales charges (or loads) and other fees.***

- To receive accurate and timely regular statements of your account, including detailed transactional information.

* * *

Responsible Investment Advice

- If desired, to be provided with appropriate investment guidance based on your personal objectives, time horizon, risk tolerance and other as disclosed by you.

- ***To be apprised of significant conflicts of interest identified in a financial relationship between an investor and his or her broker dealer or account representative.***

(Emphasis added).

89. Merrill Lynch's cash sweep program violated its own "Guidelines for Business Conduct" and its "Commitment to Clarity" and "Investors Bill of Rights," in that billions of dollars of its clients' uninvested cash were automatically swept – not into higher yielding money market accounts – but into affiliated bank accounts so that Merrill Lynch was able to use its clients' uninvested cash for ***its own profit***, while paying its clients (presently) as little as 1.4%.

2. <u>Merrill Lynch False and Misleading "Sweep" Disclosures</u>

90. Merrill Lynch implemented its bank sweep program beginning in March 2000. Under Merrill Lynch's program, excess cash in Cash Management Accounts ("CMAs") at Merrill Lynch were swept by default into accounts at banks which Merrill Lynch owned and controlled, rather than into money market funds, as had been performed previously. The only sweep alternatives available to customers were tax-free money market funds.

91. Initially, Merrill Lynch provided a rate of interest that was 0.05% higher than the rate previously available for cash in its CMA accounts, although from the outset, Merrill Lynch planned to pay lower interest rates under a tiered structure. Effective June 6, 2001, Merrill Lynch began to provide substantially below-market rates of interest for sweep accounts to all except its wealthiest clients.

92. In a press release issued on January 8, 2003 Merrill, touted that it was, according to *Barron's*:

> "the No. 1 private bank rated by total assets. In addition, **Merrill Lynch Bank USA and Merrill Lynch Bank & Trust Co., with combined retail deposits of $65 billion, ranks among the top 10 U.S. banks based on deposits.**"

(Emphasis added). At the same time, according to a March 2006 iMoneyNet study, Merrill Lynch's previous primary money market sweep option had been discontinued:

> ***The CMA Money Fund, the original sweep vehicle that has not been available for that purpose for the past six years***, had reported peak assets of $68.2 billion in early April 2000. The fund's assets totaled just $7.06 billion as of Jan, 31, although its reported seven-day simple yield as of that date was 3.84 percent, a yield that could be eclipsed only by customers with more than $10 million in the ML Bank Deposit Program....

(Emphasis added). Merrill Lynch was therefore able to grow a banking operation that ranks in the very top tier of U.S. banks born almost exclusively out of its duplicitous bank sweep program.

93. In September 2005, Merrill Lynch ***precluded*** new customers with assets at Merrill Lynch of less than $250,000 from affirmatively electing even a tax-free money market sweep account option.

94. In an *Investment News* article entitled "Wirehouse Sweeps Raising Concerns," published on December 12, 2005, it was reported that "Merrill Lynch had increased its deposit base from $6 billion in 1999 to $66 billion as of 2004." This is the result of Merrill Lynch's

emphasis on increasing bank deposits to use for lending purposes. According to the article, "[b]ecause [brokerage] firms want to increase bank deposits, they discourage the use of money market funds...." The article included a quote by a Merrill Lynch representative that

> "Figuring out money markets here is a science," said a Merrill rep in the Mid-Atlantic, who requested anonymity. '***Brokers must manually enter orders for money funds,' he said, which most brokers won't bother with. "I think the firm is counting on that***," the rep said.

(Emphasis added)

95. In its 2006 Form 10-K, Merrill Lynch disclosed, under a heading entitled "Deposit Funding" that as of December 29, 2006, its "bank subsidiaries had $84.1 billion in customer deposits, which provide a diversified and stable base for funding assets within those entities." Merrill Lynch also stated that its "U.S. deposit base of $62.3 billion includes an estimated $52.9 billion of FDIC-insured deposits which we believe are less sensitive to our credit rating." **We predominantly source deposit funding from our customer base in the form of our bank sweep programs** and time deposits." Further investigation of time deposits demonstrates they are paltry when compared with the deposits made from the bank sweep programs. Like the other Defendants, Merrill Lynch's affiliated banks exist primarily as a result the Defendant's bank sweep programs.

96. According to a March 26, 2007 *Investment News* article, "Merrill Lynch was recently paying about 1.4% on its deposit account, versus nearly 5% on a money fund."

a. Merrill Lynch False And Deceptive "Maximizes Day To Day Finances" And "Keeps Money Working" Representations

97. At a "Cash Management Account" webpage, Merrill Lynch stated that its cash sweep program was one of the ways Merrill Lynch "maximizes day to day finances and "keep[s] your money working", as follows:

WHAT IS THE MERRILL LYNCH CASH MANAGEMENT ACCOUNT®?

At Merrill Lynch, we understand you want to maximize both your long-term investments and day-to-day finances. Managing both within a single relationship provides you with a more comprehensive view of your assets, making it easier to monitor and track your overall financial picture.

WHEN SHOULD YOU CONSIDER A CMA® ACCOUNT?

If you're seeking the convenience and simplicity of an investment account that offers an automatic sweep of cash balances, a comprehensive array of cash management tools and a quick, easy way to monitor and manage financial assets, you can benefit from consolidating funds in a Merrill Lynch CMA® account.

WHAT ARE THE BENEFITS OF A CMA ACCOUNT?

Manage all your financial assets in one place

With a CMA account, you can invest, save, borrow and spend. Manage a wide range of investments with a CMA account and benefit from a full array of everyday transaction services, such as check-writing, direct deposit, online bill payment, ATM transactions, a deferred debit Visa card and more.

Keep your money working with an automatic sweep.

To ensure your money keeps earning interest, cash balances are automatically swept into your choice of tax-exempt money market funds or deposit accounts through the Merrill Lynch bank deposit program.

Earn potentially higher rates by linking accounts

The interest rates on deposits made through the Merrill Lynch bank deposit program vary based on the value of assets in your accounts. With our statement-linking feature, statements for your different Merrill Lynch accounts are packaged in one envelope with summary pages, and the total assets of all of the eligible linked accounts will be used to determine your interest rate.

(Emphasis added; footnotes omitted)

98. The statements in the preceding paragraph were false and deceptive since, *inter alia*, under the cash sweep program, Merrill Lynch did not maximize Plaintiffs' "short term finances" or "keep money working" effectively but rather ensured client cash was sweep into

banks accounts where defendants could use the cash to truly "maximize" Merrill Lynch's own profit.

b. Merrill Lynch Deceptive Description Of Bank Deposit FDIC Insured Option

99. In a footnote to the "Keep your money working" paragraph of the "Cash Management Account" webpage, Merrill Lynch states that a money market alternative is available only for clients with assets of $250,000 emphasizing, however, that money funds are not FDIC insured:

> With the Merrill Lynch bank deposit program, Merrill Lynch opens deposit accounts on behalf of CMA clients at two Merrill Lynch-affiliated FDIC-insured institutions, Merrill Lynch Bank USA and Merrill Lynch Bank & Trust Co. Merrill Lynch, Pierce, Fenner & Smith Incorporated is not a bank and is separate from these FDIC-insured affiliates. Except where indicated, securities sold, offered or recommended by Merrill Lynch are not insured by the Federal Deposit Insurance Corporation and are not obligations of, or in any way endorsed or guaranteed by, any bank. Merrill Lynch is solely responsible for its own contractual obligations and commitments. **Only clients with assets of $250,000 or more are eligible for the money funds.** For a current prospectus of Merrill Lynch money funds, which contains more complete information, please call your Financial Advisor. Before investing, consider the investment objectives, risks, and charges and expenses of the fund. This information may be found in the fund's prospectus. Read the prospectus carefully before investing. **Investing in the money market funds are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.** Although the funds seek to preserve the value of your investment at $1 per share, it is possible to lose money by investing in the funds.

(Emphasis added).

100. The statements in the preceding paragraph, *supra*, are false and deceptive since, *inter alia*, as any unconflicted "Financial Advisor" is aware, the FDIC insured feature of the Defendant bank accounts in no way justifies placing client uninvested cash in such low interest bearing accounts since money market funds pose no meaningfully greater risk justifying the significantly lower yield to the client.

c. Merrill Lynch Deceptive Disclosure Of "Tiers"

101. In a two page 2001 notice that Merrill Lynch sent to its customers with the title, "Information Statement Regarding Changes to Interest Rates on Deposits in the Merrill Lynch Banks," (the "2001 Information Statement"), Merrill Lynch made the following disclosures about the adoption of a tiered bank sweep account structure:

> **Changes in Interest Rates**
>
> Effective June 6, 2001, the interest rates paid to clients with deposits held at the Merrill Lynch Banks through the MLBA [Merrill Lynch and RASP programs will not be determined with reference to the yields of the CMA Money Fund or the Merrill Lynch Retirement Reserves Money Fund (Class I) (the "Funds") or any premium over those yields. Instead, the Merrill Lynch Banks will set interest rates based on economic and business conditions, and interest rates will be tiered based upon your relationship with Merrill Lynch as determined by the value of assets in your account(s). Generally, deposits of clients in higher Asset Tiers (as defined below) will receive higher interest rates than deposits of clients in lower Asset Tiers.
>
> Your interest rate will correspond with your Asset Tier as determined by the value of assets in your account or in accounts linked through the Merrill Lynch Statement Link Service (discussed below). The initial Asset Tiers will be:
>
> - $10,000,000 or more
> - $1,000,000 to $9,999,999
> - $100,000 to $999,999
> - less than $100,000
>
> At the commencement of these changes, the Merrill Lynch Banks expect that clients with less than $1 million in assets at Merrill Lynch will receive interest rates below the then-current rate on the CMA Money Fund. At commencement, they also expect that clients with assets less than $100,000 will receive a rate no lower than 100 basis points (1.0%) below the CMA Money Fund's then-current rate.

102. The statements in the preceding paragraph were deceptively false and misleading since, *inter alia*, it was not disclosed that no *bona fide* unconflicted "Financial Advisor" would permit the placement of uninvested cash in low interest bearing bank accounts instead of in money market funds and that the only justification for doing so was for Merrill Lynch to reap

billions of dollars in profit from commercially lending and investing its clients' uninvested cash for Merrill Lynch's own profit.

d. Merrill Lynch Deceptive "Alternatives" Disclosures

103. The 2001 Merrill Lynch Information statement only contained the following disclosure about at the end of the first page about alternatives to receiving tiered bank interest rates:

> ***You should review your account statement and speak to your Financial Advisor or Investor Service Advisor to determine current rates. You should also compare the interest rates, account charges and other features with other accounts, cash sweep programs, and alternative investments offered by Merrill Lynch or other institutions.***

(Emphasis added.)

104. The statements in the preceding paragraph were deceptively false and misleading since, *inter alia*, in fact, Merrill Lynch provided no alternative vehicles for uninvested cash in their banks – other than allowing their cash to sit idle earning no interest at all. Further, any discussion with the clients' "Financial Advisor" would have been pointless since he or she was incented financially to have the client sweep the money into Merrill Lynch banks.

e. "Benefits to Merrill Lynch" Misrepresentations and Omissions

105. The Information Statement also contained the following disclosure about the benefits to Merrill Lynch from the change:

> **Additional Information –Benefits to Merrill Lynch**
>
> * * *
>
> Merrill Lynch & Co., Inc. is a financial services company of which Merrill Lynch and the Merrill Lynch Banks are subsidiaries. The changes described in this document will be financially beneficial to these companies. Like other depository institutions, the profitability of the Merrill Lynch Banks is determined in large part by the difference between the interest they pay on the deposit accounts (and other expenses), and the income they earn on loans, investments and other assets.

> The Merrill Lynch Banks expect that the changes to interest rates described above will lower their borrowing costs.

106. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to even attempt to disclose the billions of dollars in Merrill Lynch profit from use of clients' uninvested cash *at their clients' expense* – since that would put the lie to Merrill Lynch's purported roles as a "Financial Advisor" who put the client first.

f. Merrill Lynch Deceptive "Client *Relationship* Agreement" Disclosures

107. The front page of the "Client ***Relationship*** Agreement" ("CRA") that all clients must sign again reinforces the idea that Merrill is working in the best interest of its clients:

> ***Working with your Merrill Financial Advisor to achieve your unique goals***, you can select from a broad network of accounts, retirement plans, pricing alternatives, cash access services, payment services and credit facilities that address a range of financial needs and objectives....

(Emphasis added).

108. Merrill Lynch also stated its Client Relationship Agreement was designated to "simplify your relationship" since it would incorporate by reference the disclosure relating to other accounts. The Client Relationship Agreement was set up as the only document the client signed, and all subsequent changes, for example, in the amount of interest paid clients whose uninvested cash was swept into Merrill Lynch banks, was achieved merely by subsequent Merrill Lynch "disclosures":

> For example, if you enroll in the Cash Management Account® (CMA® account) financial service, the disclosures and account agreement for that service are incorporated in this agreement. We will provide those documents to you when you enroll.
>
> * * *
>
> ***Merrill Lynch reserves the right to offer different cash sweep arrangements for different accounts or clients. You agree that Merrill Lynch may, at its discretion and from time to time, change the cash sweep arrangement upon prior notice.***

(Emphasis added). Further, the Client Relationship Agreement "incorporated by reference" for all CMA accounts 31 pages of "the disclosures and account agreement for that service." (*See infra*, ¶¶ 111-12, 114).

109. The Customer Relations Agreement also again stated that clients should go to their Financial Advisor to discuss higher yielding cash alternatives:

> ***Additional information about linking accounts for higher interest rates, FDIC-insurance, the benefits to Merrill Lynch of bank deposits and investment alternatives for your cash balances is available from your Financial Advisor and will also be included in the written materials you will receive in connection with the establishment of your account.***

(Emphasis added).

110. The statements in the preceding paragraph were deceptively false and misleading because, *inter alia*, Merrill Lynch did not implement the cash sweep program to "achieve clients unique goals" but rather for Merrill Lynch to profit at the clients' expense. Further, it would be futile to consult a Merrill Lynch "Financial Advisor" about the program since he or she was incented to have the money sweep into the bank accounts and there were no alternative higher yielding instruments available to the Class in any event.

g. Merrill Lynch 31 Page False and Deceptive "Disclosures and Account Services"

i) Deceptive Disclosure of "Alternatives"

111. Merrill Lynch provides its CMA clients with a 31-page "Disclosures and Account Agreement" for Merrill Lynch's "Cash Management Account/Beyond Banking" program, available on Merrill Lynch's website (the "CMA Disclosures"). Buried in page four of the CMA Disclosures is a direction to discuss the cash sweep program with the "Financial Advisor":

> [42] *Interest rates for the bank deposit accounts are determined by Merrill Lynch Bank USA and Merrill Lynch Bank & Trust Co., FSB weekly (or*

> *sometimes daily) based on economic and business conditions and are subject to change.* ***Your Financial Advisor will be available to discuss alternatives for your cash or bank deposit account balances.*** *However, neither your Financial Advisor nor Merrill Lynch undertakes any obligation to ensure you receive any particular rate of interest or* ***to advise you to invest your cash or bank deposit balances in higher yielding cash alternatives.*** *The interest rates for the bank deposit accounts will be different from (and may be lower than) yields on money market funds and other cash alternatives. For current yields on bank deposit balances, call your Financial Advisor or (866) ML RATES. Current yields are also available through Merrill Lynch OnLine.*

(Emphasis in original). The CMA Disclosure also contains disclosures about the tiered bank sweep interest structure, which is described as having four interest rate tiers (less than $250,000; $250,000-$99,999; $1,000,000-$9,999,999; and $10 million or more).

112. Other disclosures about investment alternatives are made in the "Summary Information Concerning Yields" section of the CMA Disclosures. This section adds the following statement about investment alternatives (at pp. 25-26), which are repeated in part in the next section, "About the Bank Deposit Program at Merrill Lynch (at pg. 27):"

> **Investment Alternatives**
>
> [11] There are investment alternatives to cash deposits held with the Merrill Lynch Banks. Some of these alternatives ***may*** pay a higher return than the interest rate paid on deposits at the Banks or may provide additional FDIC insurance. However, these alternatives generally require that you speak to your Financial Advisor to invest or make a deposit. ***The alternatives listed under "Manual Investment Alternatives" in the chart below[2] require you to speak to your Financial Advisor to invest or make a deposit but provide an automatic withdrawal or redemption feature in order to satisfy securities and cash management transactions, including check writing and Visa® card activity.***
>
> [12] Depending on your investment objectives, liquidity needs and risk tolerance, your investment alternatives may include, but are not limited to, taxable and tax-exempt money market funds, a limited transaction deposit

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[2] There is no "chart" of investment alternatives in the CMA Disclosures. This reference appears to be to paragraph [12], which immediately follows the paragraph [11] disclosure.

> program (called the "Insured Savings Account") and certificates of deposit. While deposits held at the Merrill Lynch Banks are covered by FDIC insurance up to applicable limits, some of the available investment alternatives do not carry FDIC coverage, are subject to principal risk, and are not obligations of the Merrill Lynch Banks.

(Emphasis added).

113. The disclosures in paragraphs 111-112, *supra* were deceptively false and misleading because, *inter alia*, the Financial Advisor was not disinterested but incentivized to encourage sweep into bank accounts and the system offered *no* sweep "alternatives" to clients with lesser assets so the only real option was either artificially low interest payments or *no interest payments at all* if a client opted out of the sweep program.

ii. Deceptive Disclosures of "Benefits" to Merrill Lynch

114. Disclosures about how Merrill Lynch benefited by its use of captive banks for sweep accounts are in the "Summary Information Concerning Yields" and "About The Merrill Lynch Bank Deposit Program" sections of the CMA Disclosures, and are substantively identical (at pp. 25, 29). The "Summary Information Concerning Yields" section states:

> **Benefits to Merrill Lynch of bank deposits**
>
> [9] Deposits held at the Merrill Lynch Banks are financially beneficial to Merrill Lynch and its affiliates. For example, the Merrill Lynch Banks use bank deposits to fund current and new lending, investment and other business activities. Like other depository institutions, the profitability of the Merrill Lynch Banks is determined in large part by the difference between the interest paid and other costs incurred by them on bank deposits, and the interest or other income earned on their loans, investments and other assets. The deposits provide a stable source of funding for the Merrill Lynch Banks, and borrowing costs incurred to fund the business activities of the Merrill Lynch Banks have been reduced by the use of deposits from Merrill Lynch clients.
>
> [10] Merrill Lynch receives compensation from the Merrill Lynch Banks of up to $65 per year for each CMA and Beyond Banking account and $30 per year for each IRA that has uninvested cash balances automatically swept to the Banks under the MLBD or RASP Programs. This compensation is

> subject to change from time to time, and Merrill Lynch may waive all or part of it. Merrill Lynch pays a fee to Financial Advisors based on total client deposits swept to the Banks.

115. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to disclose the *amount* by which Merrill Lynch and its affiliates profited from bank account sweeps and that the sweep system was rigged to pay clients less interest than money market funds for the sole purpose of increasing Merrill Lynch profits at its clients expense.

116. Further, Merrill Lynch also ensured that its Financial Advisors received compensation for sweeping clients' cash into inappropriate affiliated bank and lower interest bearing bank accounts. As set forth above in paragraph 114, Merrill Lynch states: "*Merrill Lynch pays a fee to Financial Advisors based on the total client deposits swept to the Banks.*" (Emphasis added).

h. Merrill Lynch False and Deceptive Disclosures On "Recent Yields on Bank Deposits and Certain Investment Alternatives"

117. Merrill Lynch's website for account owners presently has a link to a web page entitled" Recent Yields on Bank Deposit and Certain Investment Alternatives" (the "Recent Yields" web page). That web page contains a chart showing the current yields by tier for Merrill Lynch's bank deposits and the CMA Tax Exempt Fund and current yields on money market account "Manual Investment Alternatives." The web page includes a statement that, for all except a "CMA Direct" account, "you may designate an available tax-exempt money market mutual fund as an investment alternative" where the client has assets at Merrill Lynch of

$100,000 or more,[3] and which substantively repeats the same statements about the payment of interest rates and "Investment Alternatives" made in the CMA Disclosure.

118. The disclosures in the preceding paragraph were deceptively false and misleading since, *inter alia*, they failed to disclose that there was no reason to pay clients the bank rate other than to additionally enhance Merrill Lynch's profits from the use of its clients' uninvested cash and that no *bona fide* disinterested "Financial Advisor" would ever recommend or set up a scheme which would place uninvested cash in bank account bearing interest of less than 1.5% over money market funds and that, in all events, such a scheme did not "maximize" Plaintiffs cash.

119. The Recent Yields Web Page also repeats the disclosures quoted at paragraph 114, *supra*, about the benefits to Merrill Lynch of the bank sweep accounts program. Those statements were materially false and misleading for the reasons set forth in paragraph 115, *supra*.

3. **Schwab's "Investor First" Misrepresentations**

120. In an open Letter to Investors available on Schwab's website, its namesake and founder, Charles Schwab states:

> ***From day one, I've made it our business to put the needs of the individual investor first.*** And for 30 years we've kept our clients' interest as our main focus, creating a true Wall Street alternative for all investors.
>
> ***At Schwab, our goal is simple: We want to help you reach your personal goals. That means being a place where your money works hard.*** And where you can get the guidance and support your need – whatever type of investor you are.
>
> Over the last year, we've made several changes to provide the best value possible. It's not just about the lowest-priced trade. ***It's about getting more for your money. We offer you quality personal service and remarkable investing insight at a great price.***

---

[3] The $100,000 amount is lower than set forth in the current CMA Disclosures, which set forth a $250,000 minimum.

(Emphasis added). The letter appears on a web page with a photograph of Mr. Schwab and the Statement, "***I made a commitment. I'm on the side of the investor.***" (Emphasis added).

121. In a separate Letter from the Chief Executive Officer to Shareholders, Mr. Schwab reiterated once again Schwab's commitment to put its "clients first":

> We have reconnected with our clients. ***When we put clients first, we not only help them build their financial future, but we also build trust in Schwab.*** In 2006, we averaged more than $7 billion in net new assets every month in Schwab Investor Services and Schwab Institutional. In 2007, we plan to attract more than $10 billion per month in net new assets across the entire firm.

(Emphasis added). This letter also appears on a web page with a photograph of Mr. Schwab.

122. Schwab's marketing campaign "Talk to Chuck" purports to represent that "the company's founder takes time to listen" further perpetuates Schwab's "investor first" misrepresentations and, indeed, Mr. Schwab touts that Schwab is "finding ways to better serve smaller investors":

> 'In my view, our biggest challenge – and not doubt our biggest opportunity – will be f***inding ways to better serve smaller investors, including those who are just starting out.***'
>
> - Chairman and CEO Charles R. Schwab

(Emphasis added).

123. As noted Schwab, in describing to potential and existing clients "Why Schwab," shows a picture of a professional woman with the quote, ***"For the first time, I feel like someone is really on my side."*** The web page then makes the following statement:

> **Welcome to a different kind of investment firm.**
>
> Welcome to Schwab. Here, you can enjoy a personal relationship with our investment professionals. ***We see investing from your perspective, and make recommendations based on actually listening to you and understanding your needs.***

> Experience ease and convenience – from opening your account to accessing top research. To all investors, we offer investment guidance and portfolio planning.
>
> If you want us to manage your portfolio, we also offer investment management services. ***Either way, you'll get guidance from an unbiased point of view.***
>
> ***Our goal is simple: to give you everything you need to do better.***

(Emphasis added).

124. Schwab then dedicated an entire web page to describe the "personal relationship" Schwab "Financial Advisors" provide to its clients beginning with a quote which states. "**I enjoy working with someone who's as interested in me as they are in investing.**" (Emphasis in original). The web page continues:

> At Schwab, we believe that no matter how you choose to work with us, you deserve a personal relationship based on respect and listening. It's the foundation from which we'll support your financial needs and goals.
>
> **Get the relationship that's right for you.**

(Emphasis in original).

125. Schwab's misrepresentations to Plaintiffs and other members of the Class that Schwab "Financial Advisors" have a special relationship of trust and loyalty to their clients such that the client comes first were repeated hundreds of times in print, television and other media.

126. Schwab then dedicates another page to describing itself as a "***Great Value***" (emphasis in original) highlighting its cash funds:

> **"I don't like being**
> **Overcharged and I like to**
> **know what I'm paying for."**
>
> At Schwab, it's our belief that you should always enjoy low, easy-to-understand prices, great cash rates and superior service with no compromises. Simply put, you get more for your money here.
>
> * * *
>
> **Take advantage of great cash rates and low fund fees**

- Our Mutual Fund OneSource® offers over 2,000 no-load, no-transaction-fee mutual funds— more than many of our competitors.
- ***Maximize the return on your cash*** with some of the country's best CD rates at our Schwab CD OneSource™, and shop for great money market fund rates.

(Emphasis added).

127. The Schwab "Investment Products" webpage makes equivalent statements. It begins:

> ***Find the right investments to pursue your goals***
>
> At Schwab, we not only offer a wide selection of investments but also provide leading research and resources ***to help find exactly what's right for you.***

(Emphasis added).

128. The statements in the preceding paragraphs 120-27, *supra*, were deceptively false and misleading since, *inter alia*, Schwab in implementing its cash sweep program did not "put the client first," act "on the side" of the client; give "unbiased guidance;" "or maximize" clients' returns on uninvested cash, but rather maximized Schwab's profits from use of its clients' uninvested cash at the expense of its clients' financial return.

129. Schwab states in its "Code of Business Conduct and Ethics" that "The Charles Schwab Corporation is ***committed to the highest standards of ethical conduct*** in the fulfillment of our Visions and Values." On the front-page, Schwab states that its "Vision" is to "***Provide clients with the most useful and ethical financial services*** in the world," and its "Values" are to "***Be fair, empathetic and responsive in serving our clients ... Always earn and be worthy of our clients' trust.***" (Emphasis added).

130. Schwab's cash sweep program violated its Code of Business Conduct in that billions of dollars of its clients' uninvested cash were automatically swept – not into higher

yielding money market accounts – but into affiliated bank accounts so that Schwab could use its clients' uninvested cash for ***its own profit***, while (presently) paying clients as little as below 1%.

4. Schwab's Deceptive "Sweep" Program and Disclosures

131. Schwab first introduced the use of a bank account for sweeps ("Bank Sweep Feature") effective October 27, 2003. Prior to its introduction of the Bank Sweep Feature, Schwab customers would earn interest on uninvested cash through the "Schwab One Interest Feature" – whereby Schwab would pay interest on the free credit balances in its customers' accounts. According to an August 26, 2003 *San Francisco Chronicle* article, the change was disclosed in a "four page letter and 27 pages of fine-print legalese" in which Schwab "promise[d] that its bank account will pay as much or more for its money fund for six months after Oct. 27 but won't say what it will pay after that." According to a December 13, 2004 *Euromoney Institutional Investor* article, Schwab's customers' (with assets less than $100,000) sweep monies were transferred to the bank account.

132. Schwab introduced a tiered interest rate structure for its Schwab One Interest and Bank Sweep Features in early 2005, under which customers in the lower asset tiers were paid lower interest rates than customers in higher tiers. The three tiers at that time were for customers with assets at Schwab less than $5,000; customers with assets at Schwab from $5,000.00 to $99,9999; and customers with assets of $100,000 or greater. According to an August 1, 2005 *Los Angeles Times* article, by August 1, 2005, "a Charles Schwab & Co. customer with a $25,000 account would earn 0.7% in that firm's bank sweep account," while money market funds were then paying an annualized yield of 2.70%.

133. Schwab tinkered again with the tiered interest rate structure effective July 18, 2005. In a Notice to Customers, Schwab stated that, effective that date, there would be six tiers

of interest rates for the Schwab One Interest and Bank Sweep Features: for (1) balances of less than $10,000; (2) balances of $10,000 to $24,999; (3) balances of $25,000 to $99,999; (4) balances of $100,000 to $249,999; (5) balances of $250,000 to $499,999; (6) balances of $500,000 to $999,999; (7) balances of $1,000,000 to $2,499,999 and (8) balances of $5,000,000 or more. Schwab also stated that, with the exception of trust and estate and non-IRA retirement accounts, beginning September 1, 2005, it would ***eliminate*** **new** enrollments into three sweep money market funds and that the other sweep money market funds (all municipal funds) would be restricted to Schwab customers with "household" balances of $500,000 or greater.

134. Schwab further limited access to a money market sweep alternative effective January 23, 2006. According to a November 18, 2005 *San Francisco Chronicle* article, Schwab sent customer notices providing that, "[b]eginning Jan, 23, Schwab will stop putting uninvested cash in money market funds" even for its ***current*** customers whose "household" balances were under $500,000. According to the article, a Schwab spokeswoman "acknowledged that the company will benefit from increasing funds in its bank accounts." Under the change, an "average household with $200,000 in total Schwab assets, would receive only 1.6% in interest – versus 3.3% for money market funds at the time."

135. Defendant Charles Schwab's subsidiary banks were set up almost exclusively for the express purpose of benefiting from the sweep programs. In fact, nearly all of the affiliated bank's total deposits were a result of the sweep programs. According to Schwab's 2006 Form 10-K, between its two banking subsidiaries, Charles Schwab Bank, N.A. and U.S. Trust Co., N.A., Schwab had $9.9 billion and $750 million in deposits resulting from sweep programs, respectively. That is, $10.65 billion of its total $11.02 billion (**97%**) of Schwab's total "deposits

from banking clients" reported on its 2006 balance sheet were a direct result of the sweep programs.

136. Further, in a section of Schwab's 2006 Form 10-K, entitled "Payables to Brokerage Clients," Schwab disclosed: "The **principle source of funding** for Schwab's margin lending **is cash balances in brokerage client accounts.**" (Emphasis added). Thus, in a piece of modern-day financial alchemy, this defendant was able to "purchase" the client's cash by paying a very low interest-rate on the captive deposits, while converting those funds into high-paying assets (*e.g.*, margin lending products yielding three points over prime to the bank, according to the Investment News).

137. On or about May 1, 2007, to eliminate redundancy with the Bank Sweep Program, Schwab phased out its "Schwab One Interest Feature" and began notifying its clients that uninvested cash previously swept pursuant to the Schwab One Interest Feature going forward would be swept pursuant to the Bank Sweep Feature.

a. Schwab False And Deceptive Claims "To Make The Most"; "Optimize" And "Earn Attractive Return On Cash"

138. At the present time, Schwab provides the following "sweep account" disclosures to its customers. On the Schwab website, on a page dedicated to "CDs and Money Markets," Schwab states: "***Let us help you make the most of your cash.***" The webpage then states:

> Whether used for diversification, a major purchase or daily expense, we want to make sure your cash—like all your investments—reaches its full potential.
>
> **How to manage your cash based on your needs**
> ***Optimizing your returns*** begins with allocating your cash among three cash types according to your need for liquidity and yield. In general, the longer you invest your money, the higher the return you can earn.

139. Schwab's CD and Money Market Fund page also represents:

> **Let us help you make the most of your cash**

Schwab has smart solutions to help you make the most of your cash. Access some of the highest-yielding CDs anywhere, along with a range of money market funds, to help you meet your short- and longer-term cash needs. ***Our solutions and helpful guidance make it easy to manage your cash for maximum returns.***

(Emphasis added).

140. Schwab also has a "Sweep and Interest Services" web page, which makes the following statements:

As an added benefit to our clients, every Schwab account includes a free service that pays interest on idle cash in your account. Whether you select this service at account opening or automatically receive a default service, ***our Sweep and Interest Services help ensure that you earn a yield on your short-term cash holdings.*** However, we do recommend minimizing cash held in this way, as there are higher-yielding cash alternatives offering next-day liquidity.

How the services work

- Any cash that remains in your account is automatically invested.
- The way your cash is invested depends on the type of account you have and your total household assets at Schwab.
- Your cash stays in your brokerage account and is generally available immediately to make a purchase or withdrawal.

Sweep and interest services for transactional cash

Your household balance	**Click for rates and information. Your cash may be invested in one of the following:**
Under $500,000	Bank Sweep Feature Schwab One® Interest Feature
$500,000 or more	Schwab Cash Reserves™ fund and other taxable and tax-advantaged sweep money market funds Bank Sweep Feature Schwab One Interest Feature

(Emphasis added).

141. On Schwab's webpage "CDs and Money Markets" under a tab entitled "Daily Cash," Schwab states:

> This is cash you need immediately for trading and same-day transactions, and is typically held in a checking or sweep account. We recommend minimizing cash held in this way as there are higher-yielding cash alternatives offering next-day liquidity. ***As an added benefit, every Schwab account includes a free service that pays interest on idle cash in your account. You either select this service at account opening, or automatically receive a default service.*** The three interest-bearing services currently available at Schwab are as follows:

Sweep and Interest Services	**Time Horizon**	**Investment Minimum**	**Rate as of 02/12/07**
Bank Sweep Feature	Immediate	$0	1.03% - 3.06%
Schwab One Taxable Interest	Immediate	$0	1.03% - 3.06%
Sweep Money Market Funds	Immediate	$0	(For household balances of $500,000+) 7-day yield 4.63% (SWSXX)
Learn more about sweep and interest-bearing services.			
Smart cash-investing ideas:			
Consider purchased money market funds and benefit from higher yields and next-day liquidity when you sell shares of the fund.			

(Emphasis added).

142. Schwab's "CDs and Money Markets" and "Sweep and Interest Services" web pages contain a link to a separate page regarding the "Schwab One Interest Feature":

> **Schwab One Interest Feature**
>
> ***At Schwab, we are committed to helping you earn an attractive return on your full portfolio, including your cash.*** For cash awaiting investment, we provide the rates noted below. This interest feature comes automatically with your Schwab brokerage account and is designed specifically for "transactional cash." For "investment cash" that you intend to hold as a core component of your portfolio, we offer several higher-yielding options.
>
> For further information, see the Disclosure Statement for Schwab Cash Features and the Changes to the Disclosure Statement for Schwab Cash Features.

Interest Rates

Household Balances	Interest Rate (as of 2/21/07)	Annual % Yield (APY)
<$10K	0.98%	0.985%
$10K<$25K	0.98%	0.985%
$25K<$100K	0.98%	0.985%
$100<$250K	2.57%	2.603%
$250K<$500K	2.57%	2.603%
$500K<$1M	2.57%	2.603%
$1M<$2.5M	2.57%	2.603%
$2.5M<$5M	2.57%	2.603%
$5M+	3.00%	3.045%

(Emphasis added).

143. Schwab's "CDs and Money Markets" and "Sweep and Interest Services" web pages also contain a link to a separate page regarding the "Bank Sweep Feature" which repeats verbatim the Schwab Interest One Feature's language and tiered interest rate structure, as set forth in the preceding paragraph.

144. The statements in paragraphs 138-143, *supra*, were deceptively false and misleading since, *inter alia*, they failed to disclose that there was no reason to pay clients the bank rate other than to additionally enhance Schwab profits from the use of its clients' uninvested cash and that no *bona fide* disinterested "Financial Advisor" would ever recommend or set up a scheme which would place uninvested cash in bank account bearing interest of less than 1% over money market funds and that in all events such a scheme did not "make the most;" "optimize" or provide a Plaintiffs' cash.

b. 2004 Deceptive "Bank Deposit" and "Benefits" to Schwab's Disclosures

145. In 2004, Schwab subsequently issued a sixteen page "Disclosure Statement for Schwab Cash Features" reiterating how the "Bank Deposit" feature worked:

12. How the Bank Deposit Feature Works

Selection of Sweep Banks. There are two Sweep Banks participating in the Bank Deposit Feature: Charles Schwab Bank, N.A. ("Schwab Bank") and U.S. Trust Company, N.A. ("U.S. Trust"). Your Free Credit Balances will be deposited in Deposit Accounts at the Sweep Bank as indicated on your Account Application or disclosed to you in a separate advance notice.

13. Changes to Sweep Banks

* * *

Interest. Each Sweep Bank will pay the same interest rate on the NOW Account and MMDA. Interest rates will be established periodically by the Sweep Bank based on prevailing market and other business conditions.

The Sweep Banks pay interest on balances in the Deposit Account based on the tiers as determined by your Household Balances. Generally, clients with greater Household Balances will receive a higher interest rate than clients with lower Household Balances. . . . The Sweep Banks are not obligated to pay different interest rates on different tiers. Schwab may change the tiers from time to time....

* * *

The interest rates paid with respect to the Deposit Accounts may be higher or lower than the interest rates available to depositors making deposits directly with the Sweep Bank or other depository institutions in comparable accounts.

146. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to disclose that there was no reason to pay clients the bank rate other than to additionally enhance Schwab profits from the use of its clients' uninvested cash and that no *bona fide* disinterested "Financial Advisor" would ever recommend or set up a scheme which would place uninvested cash in bank account bearing interest of less than 1% over prevailing money market funds.

147. In addition, the "Disclosure Statement for Schwab Cash Features" purported to describe the "benefits" to Schwab under the Sweep Bank Feature:

16. Benefits to the Sweep Banks, Schwab and The Charles Schwab Corporation

> The Sweep Banks intend to use the cash balances in the Deposit Accounts to fund current and new lending activities and investments. The profitability on such loans and investment is generally measured by the difference, or "spread," between the interest rate paid on the Deposit Accounts, and the interest rate and other income earned by the Sweep Bank on the loans and investments made with the fund in the Deposit Accounts. The income that the Sweep Bank will have the opportunity to earn through its lending and investing activities is expected to be greater than the fees earned by Schwab and its affiliates from managing and distributing the Sweep Funds. Such deposits are anticipated to provide a stable source of funds for the Sweep Bank's lending and investment activities. The cash balances may also be used to provide fund to develop products and services for Schwab-affiliated companies to the extent permitted by applicable law.
>
> Schwab may receive a fee from the Sweep Bank of up to one-half of one percent (0.5%) of the average daily deposit balance held by the Sweep Bank in Deposit Accounts established by it at the Sweep Bank. Schwab may waive any or all of this fee. Other than applicable fees imposed by Schwab on brokerage Accounts, there will be no charges, fees or commissions imposed on your Account with respect to Bank Deposit Feature.

148. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to meaningfully disclose the true benefits to Schwab of its Cash Feature program by quantifying Schwab's massive profits in terms of the percentage yield from commercial lending or investing of 8% or higher and the absolute dollar amount in terms of hundreds of millions of dollars.

149. Schwab also ensured that its financial representatives received compensation for sweeping clients' cash into inappropriate affiliated bank and lower interest bearing bank accounts. Schwab's website on a separate web page entitled "Representatives' Compensation," Schwab sets forth the criteria by which it pays its financial advisors (representatives). Schwab states: "[s]ome of these plans are based on revenue Schwab earns from clients or from product sales. *Schwab may pay a Schwab representative more for selling products or services on which Schwab makes more money.*" (Emphasis added).

c. Schwab's Deceptive March 2007 Disclosures Client To "Monitor Cash" And "Rates Of Return" Misrepresentations And Omissions

150. After the initiation of this lawsuit against Schwab, it issued, in March 2007, a new and revised eighteen page "Cash Features Disclosure Statement for Individual Investors," which disclosed, in pertinent part, as follows:

Cash Features Disclosure Statement for Individual Investors

1. Introduction

* * *

... **If you are offered a choice of cash features on your application, you must designate an eligible cash feature for your account.** ***If you do not, or if you designate an ineligible cash feature, you will be enrolled in the cash feature indicated on your application.***

If you have $500,000 or more in Household Balances, you may request a sweep fund as an alternative by speaking to your Schwab representative. ***The yields of sweep funds are generally higher than those offered under either the Schwab One® Interest or the Bank Sweep feature.*** A description of how we determine the Household Balance is contained in your account's pricing guide.

2. Your Responsibility to Monitor

It is your responsibility to monitor your eligibility for the cash features and determine the best cash feature available to you. Schwab is not responsible for contacting you if you are, or later become, eligible for other higher yielding cash features. Information about eligibility for particular cash features is available at any time by contacting us or by going to www.schwab.com/cash.

3. Rates of Return

Current rates for each cash feature can be obtained by calling us at 1-800-435-4000 or by going to www.schwab.com/cash.

There is no guarantee that the rate of return on any particular cash feature will be, or will remain, higher than other cash features over any period. However, historically, the interest rates paid under the Schwab One® Interest feature and the Bank Sweep feature have been lower than the yields available through the sweep fund feature.

Sweep funds seek to achieve the highest rate of return (less fees and expenses) consistent with prudence and their investment objectives.

> Interest rates under the Schwab One® Interest feature are established periodically by Schwab based on prevailing market and business conditions.
>
> Interest rates under the Bank Sweep feature are established periodically by Schwab Bank based on prevailing market and business conditions.
>
> ***Unlike the yields of sweep funds, the rates on the Schwab One® Interest feature and the Bank Sweep feature vary by tiers as determined by your Household Balance***—in general, clients with higher Household Balances earn a higher rate than those with lower balances. A description of how we determine the Household Balance is contained in your account's pricing guide.
>
> These cash features are not intended for long-term investments. You should consider higher-return options for funds that are not needed immediately. Please visit www.schwab.com/cash for investment alternatives.

(Emphasis added).

151. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, the cash sweep system was rigged for clients with lesser assets such that there were no cash sweep options to monitor.

d. <u>Schwab One Brokerage Account Application</u>

152. Schwab's "Schwab One Brokerage Account Application", used by all Schwab customers in opening a Schwab brokerage account, contained the following disclosure regarding Schwab's Cash Feature:

> **Cash Feature**
> ***Schwab provides various alternatives for you to earn income on the uninvested cash in your Account.*** These "Cash Features" are described in Schwab's Disclosure Statement for Cash Features, which you will receive at account opening. You may select an eligible Cash Feature by speaking with a Schwab Representative. Until you designate a different Cash Feature, Schwab will pay you interest on cash awaiting investment in accordance with the Schwab One Interest feature.*
> * The Schwab One Interest Feature is not a bank account and is not FDIC-insured.

(Emphasis added.)

153. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to disclose that Schwab's sweeping of cash into low paying affiliated-bank accounts was not suitable or in the best interest of their clients and was only implemented for Schwab to achieve massive profits at its clients' expense. Additionally, Schwab's only "alternative" for clients with assets below $500,000 was the "Schwab One Interest" feature. But this "alternative" was also rigged only to benefit Schwab. The Schwab One Interest feature paid extremely low interest comparable to the Bank Sweep feature, but allowed Schwab's brokerage division to lend and invest uninvested client cash for its own benefit.

5. Morgan Stanley "Client Number #1" Misrepresentations and Omissions

154. Morgan Stanley's "Global Wealth Management" web page for "Individual Investors" states that Morgan Stanley is "Dedicated to giving individual investors the finest thinking, products and services in the financial world." Morgan Stanley also states, "We offer tailored solutions designed to help you manage your long-term wealth as well as customized investment solutions and services for individuals of substantial means, families and foundations. Whatever your needs, we are here to help you to succeed."

155. Morgan Stanley's Individual Investor web page is linked to a web page describing the role of the Morgan Stanley "Financial Advisor" as follows:

> **Your Financial Advisor**
>
> ***Obtaining your financial goals is number one on your list; it is also number one on your Financial Advisor's list.***
>
> ***Our client-centered approach includes a disciplines five-step process that enables us to work with you to craft a solution to help meet your individual financial needs.*** Through this process we will help you:

- ***Develop a thorough understanding of your financial goals and objectives***
- Review and analyze your current financial situation
- ***Identify and tailor solutions that can help you meet your individual needs***
- Implement your customized strategy, including personalized services and benefits
- Monitor progress, periodically review strategies and we will maintain an ongoing commitment to you

All in all, your Financial Advisor will help grow, protect, and distribute your assets and overcome any potential obstacles that may arise. He or she brings a comprehensive, strategic approach to all aspects of your personal finance including:

Brokerage Solutions
- Investments
- Education Planning Services
- Lending Services
- Financial Assessment Tools

Advisory Solutions
- Financial Planning
- Managed Accounts

Life Cycle Solutions
- Insurance Coverage
- Personal Trust (Morgan Stanley Trust, NA)
- Wealth Planning Services ...

156. Morgan Stanley's Individual Investor web page is linked to a Morgan Stanley web page entitled "Working Together." This page represents to investors that "You and your Morgan Stanley Financial Advisor, with access to the full scope of our services and resources, ***work closely together towards achieving your financial success.***" (Emphasis added.)

157. A further linked web page is entitled "Our Statement of Commitment to Investors." It states, in part:

> **Your relationship with Morgan Stanley is about more than investing money. It's about sharing your aspirations and building a relationship with your Financial Advisor.**

- Your primary contact with us is through your Financial Advisor. We will put the resources of our firm behind your Financial Advisor to help you pursue your goals
- ***Your Financial Advisor is committed to understanding you, your financial needs, your investment objectives, your tolerance for risk, your time horizon and any other factors that may affect our recommendations***
- ***We will help you understand your investment choices***
- Your Financial Advisor will help you set realistic expectations about the long-term performance and associated risks of those choices
- Your Financial Advisor will be available for regular conversations with you about the status of your investments with us and changes in your personal profile
- ***We will provide timely account and transaction information that accurately reflects the investment positions you hold with our firm***
- We will disclose information related to the way we are paid by you as a client, including commissions and fees associated with your account. We will answer questions you have about how your Financial Advisor is paid
- We will disclose information regarding payments we receive from third parties for the products and/or services in your account.

* * *

- We will do our best to build and justify your trust in us

(Emphasis added).

158. The aforementioned Morgan Stanley misrepresentations and nondisclosures to Plaintiffs and other members of the Class that Morgan Stanley financial advisors have a special relationship of trust and loyalty to their clients such that the client are number one were repeated hundreds of time in print, television and other media throughout the Class Period.

159. The statements in the preceding paragraphs 154-58, *supra*, were blatantly false since, *inter alia*, the only justification for Morgan Stanley sweeping its clients' cash into Morgan Stanley banks and then paying its clients below money market rates for Morgan Stanley's use of its client cash was Morgan Stanley putting the "resources of our firm" behind *itself – not its clients* – to profit at the expense of the customers, and failing to "help you [the client] understand your investment choices." Rather than help clients "understand" their investment choices for

free cash, Morgan Stanley made (as set forth at ¶¶ 162, 165-66, 168, 171, 173, *infra*) buried and inadequate misleading partial disclosures.

160. Morgan Stanley has also represented to investors that it has developed and all employees and officers have adopted a "Code of Ethics," which codifies the "core values that define our company." Morgan Stanley claims to recognize that "the firm's clients, shareholders, competitors and the public have come to expect more from us than simple obedience to the letter of the law. They expect the highest degree of ethics, honesty and fairness in all our dealings."

161. Morgan Stanley's cash sweep program has violated its own Code of Ethics in that billions of its clients' uninvested cash were automatically swept – not into higher-yielding money market accounts – but into affiliated bank accounts so that Morgan Stanley was able to use its clients' uninvested cash for ***its own profit***, while paying its clients (presently) as little as 1.25%.

6. **Morgan Stanley Deceptive, False and Misleading Sweep Disclosures**

162. As reported in a December 12, 2005 *Investment News* article Morgan Stanley began sweeping customer funds into a bank account at a Morgan Stanley-owned bank in November 2005:

> Morgan Stanley & Co. Inc. last month became the latest wirehouse to sweep customers' cash into bank deposit accounts.
>
> Some brokers say they are concerned about the new policy, because many clients will get significantly lower yields than they were getting on money market funds.
>
> * * *
>
> Clients with less than $100,000 in assets at the firm were earning just 1.36% on their cash, based on rates quoted to brokers this month. The next tier, for $100,000 to $1 million households, was earning 2.61%, households with $1 million to $10 million were getting 3.2%, and $10 million-plus households were receiving a rate of 3.6%.

Current money fund rates were in the 3.5% to 3.6% range at the time.

The new policy does not apply to retirement plans or individual retirement accounts, and clients who were sweeping cash into tax-free funds were not affected, said a Morgan Stanley spokeswoman. Existing accounts will receive a flat money market rate for at least six months.

Although the bank fund is used as the default sweep option, clients can opt to sweep cash into a tax-free money fund, the spokeswoman added.

A 'money scam'

The policy "is not consistent with the strategy of offering the best products at the best price," said a Morgan Stanley rep in the Midwest. ***"All it does is scam money" from clients***, said the rep, who asked not to be identified.

*"**It's very much a profit deal for Morgan Stanley,"** said another Morgan broker, based on the West Coast, who also asked not to be identified.*

* * *

Morgan Stanley clients received a detailed explanation of the bank deposit program in early September, the spokeswoman said. Assets in existing money market funds will not be transferred.

(Emphasis added).

163. In 2006, *net revenues* in Morgan Stanley's Global Wealth Management Group were reported at $5.5 billion, an increase of 10% from the previous year. Morgan Stanley, in its 2006 Form 10-K, specifically credits this to "**higher net interest revenue from the bank deposit program [deposits from client brokerage accounts]** and an increase in revenues from fee-based products." (Emphasis added). Morgan Stanley reported in its 2006 10-K that, "**Net interest revenues increased 52%** and 28% **in fiscal 2006** and fiscal 2005, respectively." (Emphasis added). Further, Morgan Stanley reported, "**The increase in fiscal 2006 was primarily due to increased customer account balances in the bank deposit program that was launched in November 2005. Balances in the bank deposit program rose to $13,301 million [$13.3 billion] at November 30, 2006 from $1,689 million [$1.7 billion] at November**

30, 2006." (Emphasis added). Therefore, as a direct result of its bank deposit program, Morgan Stanley's deposits increased by approximately $11.6 billion in 2006, which represents growth of approximately 682% from the previous year's levels.

164. In addition, Note 6 to Morgan Stanley's 2006 Form 10-K lists total deposits from "Demand, passbook, and money market accounts" at $14.7 billion. When compared to the $13.3 billion credited to the bank deposit program, it is apparent that approximately 90% of these deposits resulted from Morgan Stanley's brokerage client account sweep programs. Further, total deposits were $28.3 billion, which indicates that 47% of Morgan Stanley's *total deposits* were the result of the bank deposit sweep program.

a. Morgan Stanley Deceptive "Keeps Your Money Working Harder" Misrepresentations

165. Cash sweeps were offered through Morgan Stanley's "Active Assets Account," which is described having the following benefits for investors:

> The Active Assets Account offers ***a robust suite of benefits and services***, including:
>
> - ***Practical investment features that keep your money working***
> - ***Essential cash management services to simplify your financial life***
> - Unparalleled reporting so you're always in control of your money
> - A generous client benefits program, if you qualify
> - Premium Morgan Stanley Debit MasterCard® Card

(Emphasis added).

166. At a web page entitled "Keep Your Money Working With Practical Investment Features" web page that is linked to the "cash management services" line quoted in the last paragraph and that is also referred to in the Bank Deposit Disclosure Statement, Morgan Stanley states:

> No matter how you choose to put your money to work, ***the Active Assets Account offers valuable investment features to keep it working harder.***

(Emphasis added). Those features included an:

> Automatic cash sweep – Available cash balances are automatically swept into bank deposit accounts (rates) or a money market fund (rates).

167. The statements in paragraphs 165-66, *supra*, were deceptively false and misleading since, *inter alia*, they failed to disclose that there was no reason to pay clients the bank rate other than to additionally enhance Morgan Stanley profits from the use of its clients' uninvested cash and that no *bona fide* disinterested "Financial Advisor" would ever recommend or set up a scheme which would place uninvested cash in bank account bearing interest of less than 1% over money market funds and that in all events such a scheme did not "keep cash working" for Plaintiffs.

b. Morgan Stanley 2006 Deceptive Sweep Disclosures

168. In March 2006, Morgan Stanley issued a "Bank Deposit Program Disclosure Statement," which purports to inform investors about Morgan Stanley's Bank Deposit Program.

169. Morgan Stanley made the following disclosures in the Bank Deposit Program Disclosure Statement about how the Bank Deposit Program and the adoption of a tiered structure.

> **Introduction**
>
> Under the Bank Deposit Program (the "Program"), free credit balances in your Morgan Stanley brokerage account ("Account") will be automatically deposited into deposit accounts ("Deposit Accounts") established for you by Morgan Stanley DW Inc. ("Morgan Stanley") at Morgan Stanley Bank, a Utah chartered industrial bank ("Morgan Stanley Bank"), and Discover Bank, a Delaware chartered bank ("Discover Bank"), each an affiliate of Morgan Stanley (each a "Sweep Bank"). The Deposit Accounts at each Sweep Bank are established in the name of Morgan Stanley, as agent and custodian for its clients, and consist of a Negotiable Order of Withdrawal ("NOW") account and a money market deposit account ("MMDA").

* * *

Interest on the Deposit Accounts

* * *

The interest rates on the Deposit Accounts will be tiered based upon the value of eligible assets in your Account ("Eligible Assets") and deposits, if any, that you have established directly in your name with Sweep Bank ("Direct Bank Deposits"). In general, the greater the value of your Eligible Assets and your Direct Bank Deposits, the higher the interest rate on your Deposit Accounts.

Current interest rate tiers are:
$0 - $99,999
$100,000 - $999,999
$1 million - $9,999,999
$10 million and above

The interest rate tiers may be changed without notice to you. On any day there may be no difference in the interest rates on different tiers.

* * *

Program Amendment and Additional Depository Institutions

Morgan Stanley, at is discretion, may modify the terms, conditions and procedures for the Program. Morgan Stanley will notify you of any changes that adversely affect you. All such notices may be made by means of a letter or an entry on your Account statement or by other means.

Morgan Stanley, at is sole discretion and at any time, many add depository institutions to the Program or change the deposit and withdrawal procedures....

170. The statements in the preceding paragraph failed to disclose that there was no reason to pay clients the bank rate other than to additionally enhance Morgan Stanley profits from the use of its clients' uninvested cash and that no *bona fide* disinterested "Financial Advisor" would ever recommend or set up a scheme which would place uninvested cash in bank account bearing interest of less than 1% over prevailing money market funds.

c. <u>Morgan Stanley Deceptive "Alternatives" Disclosures</u>

171. The Bank Deposit Program Disclosure Statement (at pg. 3) includes the following paragraph about alternatives to the bank sweep program:

> The interest rates paid with respect to the Deposit Accounts at the Sweep Banks may be higher or lower than the interest rates available on other deposit accounts offered by a Sweep Bank or on deposit accounts offered by other depository institutions. ***You should compare the terms, interest rates, required minimum amounts, and other features of the Deposit Accounts with other deposit accounts and alternative cash investments. You may obtain information with respect to the current interest rates and interest rate tiers by consulting your Financial Advisor or accessing Morgan Stanley's public Web site at:*** www.morganstanleyindividual.com/accountoptions/activeassets/Investmentfeatures/.

172. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, there were no "alternatives cash investments" offered to Plaintiffs with lesser assets except to receive no interest on uninvested cash, and so the program was rigged to ensure the uninvested cash went to Morgan Stanley banks for those clients. Further, the "Financial Advisor" was incentivized to also ensure that Morgan Stanley's clients moved cash into its affiliate banks even though no *bona fide* "Financial Advisor" would recommend – much less implement – such an investment of uninvested cash in place of money market funds.

d. <u>"Benefits" to Morgan Stanley Misrepresentations and Omissions</u>

173. The Bank Deposit Program Disclosure Statement makes the following statements about the "benefits" to Morgan Stanley from the bank sweep program:

> **Fee to Morgan Stanley**
>
> Morgan Stanley will receive an annual fee, payable monthly, from each Sweep Bank of 0.25% of the average daily deposit balances in the Deposit Accounts at that Sweep Bank, subject to modifications of the arrangement by the parties. Of the fee received by Morgan Stanley, your Financial Advisor receives credit of 0.10% of the average daily deposit balance in your Deposit Accounts and is paid a portion of this credited amount based on his or her payout rate.
>
> Other than the applicable fees imposed by Morgan Stanley based on your Account, no other charge will be imposed on your Account with respect to the Program.
>
> **Other Benefits to Morgan Stanley, the Sweep Banks and their Affiliates**

> Morgan Stanley, the Sweep Banks and their affiliates receive other financial benefits in connection with the Program.
>
> Morgan Stanley receives other compensation in connection with the Program. Such compensation is based on a formula which takes into account the funds deposited through the Program. Generally, such compensation to Morgan Stanley will increase as more funds are deposited through the Program. The amount of such compensation may vary and is reflected by allocations made for financial reporting purposes.
>
> Through the Program, each Sweep Bank will receive a stable, cost-effective source of funding. Each Sweep Bank intends to use deposits in the Deposit Accounts at the Sweep Bank to fund current and new businesses, including lending activities and investments. The profitability on such loans and investments is generally measures by the difference, or "spread," between the interest rate paid on the Deposit Accounts at the Sweep Bank and the other costs of maintaining the Deposit Accounts, and the interest rate and other income earned by the Sweep Bank on those loans and investments made with funds in the Deposit Accounts. The income that a Sweep Bank will have the opportunity to earn through its lending and investing activities is expected to be greater that the fees earned by Morgan Stanley and its affiliates from managing and distributing the money market funds available to your as a sweep investment.

174. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to disclose the *amount* by which Morgan Stanley and its affiliates profited from bank account sweeps and that the sweep system was rigged to pay clients less interest than money market funds in order to increase Morgan Stanley's and its affiliates' profits at its clients' expense.

175. Morgan Stanley also ensured that its financial representatives received compensation for sweeping clients' cash into inappropriate affiliated bank and lower interest bearing bank accounts. As set forth above in paragraph 173, Morgan Stanley states: "[o]f the fee received by Morgan Stanley, *your Financial Advisor receives credit of 0.10% of the average daily deposit balance in your Deposit Accounts* ...." (Emphasis added).

7. Smith Barney "Financial Advisor" Misrepresentations and Omissions

176. In a section of its web page called "Working with Your Financial Advisor," Smith Barney emphasizes the importance in confiding and relying on the personal relationship with the Smith Barney Financial Advisor to guide the client through all of life's significant milestones:

> ***Just as your life involves more than investments, so will your relationship with your Smith Barney Financial Advisor.*** It all starts with a conversation. You might want to grab a chair, because ***you'll be asked about your fondest aspirations for yourself and your family, your feelings about where you are and where you hope to be and, of course, your fears, and the things that might prevent you from getting what you want.***
>
> Marriage House Family Retirement Legacy
>
> **Know what matters most in life, and plan accordingly**
>
> Your Financial Advisor will then work closely with Citigroup professionals who specialize in such disciplines as lending, risk management — and yes, even investments — ***to craft a comprehensive wealth management plan*** for your consideration.
>
> There's much to discuss. Let's get to work.

(Emphasis added).

177. Smith Barney also purported to have a range of expertise in "managing the wealth" of its clients. Specifically, Smith Barney states on its web site:

> **Managing Your Wealth**
>
> At Smith Barney we believe that managing your wealth is not just about having better answers, it's about asking better questions. ***Those questions are the heart of a discovery process that will enable your Smith Barney Financial Advisor to learn enough about you, your family and your goals to design a holistic, strategic plan – a plan designed to help you protect and enhance the lifestyle you've worked so hard to earn.***

(Emphasis added).

178. Smith Barney also specifically represented, that through its Financial Advisors, it engages in "***wealth management***" on behalf of its clients encompassing a whole range of

"actionable" financial strategies to "realize your most cherished hopes and defend against the things that might undo them," as follows:

> Wealth management can help you determine what's really important to you, then develop ***actionable strategies to help you realize your most cherished hopes and defend against the things that might undo them.***
>
> ***Investments? Of course. Borrowing? Strategically, yes. Managing risk? Systematically. Planning deliberately so that your wealth works to bring you a lifestyle well earned? That's where it starts.***

(Emphasis added).

179. Smith Barney touted its "Financial Management Account" ("FMA") as the "cornerstone" of its "wealth management" program as follows:

> "Financial Management Account – ***The cornerstone of your overall wealth management plan***, the Smith Barney FMA, our central asset account, ***offers you better financial control***, access to funds and account information with greater flexibility and convenience.

(Emphasis added). It is in this account that Smith Barney offers cash management sweep features.

180. In its advertising, Smith Barney has also repeatedly represented how it assists investors in reaching their financial goals and its ethical obligations to customers. For example, in and around 2004-2005, Smith Barney issued a television commercial campaign (known as "How We Earn It") that features characters portraying a retiree or businessperson describing how they reached financial security, followed by the Smith Barney taglines that "You work hard to earn it. Shouldn't your financial consultant?" and by "This is who we are. This is how we earn it."

181. The aforementioned misrepresentations that Smith Barney "Financial Advisors" have a special relationship of trust, loyalty and confidence with their clients such that the client

interests comes first were repeated literally repeated thousands of time in print, television and other media.

182. The statements in paragraphs 176-81, *supra*, that Smith Barney and its Financial Advisors will guide the client through all of life's milestones, craft a comprehensive wealth management plan, "manag[e] your wealth," design a create a strategic plan "designed to help you protect and enhance the lifestyle you've worked so hard to earn" and create "a comprehensive wealth management plan" "so that your wealth works to bring you a lifestyle well earned" are materially false and misleading since, *inter alia*, Smith Barney in fact abused its "relationship" with its clients by implementing the Bank Deposit Program ("BDP") for the sole purpose of enhancing its own profit at its clients' expense.

183. Smith Barney's claimed allegiance to its customers is also set forth in a statement to customers entitled "Our Mutual Commitment," available on Smith Barney's website. This statement was modeled from a "Statement of Investor Rights and Responsibilities" adopted by the Board of the Securities Industry Association in 2004. In the Statement, Smith Barney outlines its duties to customers, as follows:

> **Your Rights as a Client**
>
> **A client has the right to quality service, clear reporting, responsible investment advice and the prompt, fair resolution of problems.**
>
> **Quality Service**
>
> - ***To be treated in a fair, ethical and respectful manner in all interactions with Smith Barney, its employees and its affiliates.***
> - To receive competent, courteous service, and assistance, at a fair price.
>
> * * *
>
> **Clear Reporting**
>
> - To receive clear, accurate, easy-to-understand descriptions of all your transactions, statements and other communications from Smith Barney.

- ***To be informed clearly about all the costs associated with your account and the costs related to individual transactions, including commissions, sales charges (or loads) and other fees.***

- To receive accurate and timely regular statements of your account, including detailed transactional information.

* * *

Responsible Investment Guidance

- If desired, to be provided with appropriate investment guidance based on your personal objectives, time horizon, risk tolerance and any other factors you choose to disclose.

- ***To be apprised of significant conflicts of interest identified in a financial relationship between an investor and his or her Financial Advisor.***

(Emphasis added)

184. Smith Barney's cash sweep program violated its "Commitment to Investors" in that billions of dollars of its clients' uninvested cash were automatically swept – not into higher yielding money market accounts – but into affiliated bank accounts so that Smith Barney was able to use its clients' uninvested cash for ***its own profit***, while paying its clients (presently) as little as 1.42%.

8. <u>Smith Barney False And Misleading "Sweep" Disclosures</u>

185. Smith Barney – a Citigroup affiliate – was one of the first brokerage firms that offered a bank "sweep" account program, beginning in late 1997. From the Citigroup-Salomon Smith Barney merger in September 1998 until 2006, sweep monies were deposited at Citigroup-owned banks, with market rates of interest paid to Smith Barney's customers.

186. According to defendant Citigroup's 2004 Form 10-K, the most recent data available, "Balances in Smith Barney's Bank Deposit Program totaled $43 billion in 2004" which represents approximately 27% of Citigroup's $161.1 billion "interest-bearing deposits in

U.S. offices." Disclosures of the balances in Smith Barney's Bank Deposit Program are noticeably missing from both the 2005 and 2006 year end SEC filings.

187. However, in a June 6, 2006 internal memorandum to its brokers, Smith Barney announced that, as of September 1, 2006, it would adopt the same profitability model previously adopted by other defendants, and provide substantially lower interest to all except its wealthy customers. The memorandum stated that Smith Barney would continue to offer customers with more than $1 million of assets at Smith Barney a rate tied to the firms' Smith Barney Cash Portfolio Money Market Fund, which paid a ***4.45%*** interest rate. The remaining three tiers – less than $250,000; (b) from $250,000 to $499,999; and (c) from $500,000 to $999,999 – would receive ***lower*** interest rates, which were estimated to be ***1.63%***, 3.2 % and 3.6%, respectively. As one commentator noted in a July 6, 2006 Associates Press article, "'[w]ith 17 [prior] rate hikes by the Federal reserve, 1.63 percent is pretty miniscule.'"

188. According to a January 11, 2007 *Wall Street Journal* article:

> Smith Barney had considered such moves earlier, but hesitated because its former chief executive, Sallie Krawcheck, who led the firm between 2002 and 2004, ***raised questions about whether such "tiering" tactics could hurt customers***, according to people at Citigroup. ***This year the firm decided it couldn't afford to pass up the profits*** and risk being left at a competitive disadvantage, other people said.

(Emphasis added).

a. Smith Barney Website Misrepresentations Making Your Cash "Work Harder"

189. Smith Barney deceptively described its "Daily Sweep of Cash" as one of the account services provided to clients under its FMA system which demonstrated that Smith Barney ensures it makes its clients money "work harder." Smith Barney represented its FMA account with daily sweeps:

> Manage your finances with ease
> Access your funds anytime, anywhere
> ***Make your money work harder***
> Direct deposit your tax return into an FMA

(Emphasis added). Smith Barney also noted three advantages of "Direct deposit [of] your tax return into an FMA Account," including that "Your money is swept daily, ***so your refund can start earning income for you right away.***" (Emphasis added)

190. Smith Barney also created a link to a separate "Make Your Money Work Harder" web page, which again mislead Plaintiffs, into believing the Daily Sweep was enacted to benefit clients (as opposed to the truth – which was that it was created to benefit Smith Barney at the expense of its clients). The sweep account features were further described as follows:

> **Make your Money Work Harder**
>
> Daily Sweep
>
> ***In an FMA® account, your excess funds are never sitting idle.*** Cash balances of $1 or more are automatically invested into your choice of one or more FDIC-insured, interest-bearing accounts or tax-exempt money funds.

(Emphasis added). Rather than linking to further information about the FMA account's sweep and other features, the "Make Your Money Work Harder," web page states "For more information, please contact your Smith Barney Financial Advisor."

b. Smith Barney Website Deceptively Describes "Benefit" Of FDIC Protection

191. Smith Barney's also sought misleadingly to convey to its clients that sweeping their uninvested cash into bank accounts paying as low as 1.6% in interest was justified because those accounts were FDIC insured, even though *no bona fide* disinterested "Financial Advisor" would recommend foregoing money market yields of 4-5% in favor of bank account interest and FDIC insurance. Smith Barney's website also contains a "Bank Deposit Program" web page,

which is reached through the "Other Investments" link, but not the "Make Your Money Work Harder" web pages, which states:

> **Bank Deposit Program**
>
> Cash balances (from securities transactions, dividend and interest payments and other activities) in eligible client accounts are swept automatically into interest-bearing, FDIC-insured savings deposit accounts at up to three Citigroup-affiliated banks.
>
> *Your Benefits*
>
> - **Account Protection.** Insurance provided by the Federal Deposit Insurance ***Corporation (FDIC) is one of the most important benefits you receive with the Bank Deposit Program℠. Cash in your Bank Deposit Program accounts will be FDIC-insured up to a total of $100,000 per depositor, at each of the participating banks.* Since there are currently three Citigroup-affiliated banks in the Bank Deposit Program, each client will get the benefit of up to $300,000 of FDIC insurance through the sweep of cash balances to the three program banks.***
>
> For additional information, please speak to your Financial Advisor or refer to the Bank Deposit Program Disclosure Summary.

(Emphasis in original). The "current rates" link is to a web page showing the current interest rates for the bank Deposit Program tiers, Smith Barney money funds, treasury bills and notes, and corporate bonds.

c. August 2006 Provides False And Deceptive Descriptions Of "Tiers"; "Alternatives" And "Benefits" To Smith Barney

192. On or about August 1, 2006, Smith Barney sent communication to customers notifying them of the upcoming institution of the tiered program. In a sixteen page Q&A entitled "Important Information about changes to the BDP and to Sweep Options," Smith Barney stated, *inter alia*, that:

> The following changes will become effective on September 1, 2006:
>
> - ***Interest rates paid on deposited funds In Affiliated Program Banks will be "tiered" based upon the value of eligible assets in accounts included in your***

Statement Consolidation Plus Relationship. Statement Consolidation Plus is a new concept being introduced for his Program that combines the value of eligible assets in a related statement consolidations within a household (please refer to Section I. Changes to BDP, question 6 for details). ***Clients with higher total eligible assets generally will receive higher Interest rates on their funds deposited through BDP than clients with lower total eligible assets.***

(Emphasis added).

193. The change in interest rates was also referred to at pages 3-4 of the Q&A, in as follows:

Q5: How will the Interest rates on BDP balances change?

A5: Currently, all Smith Barney clients earn the same interest rate on funds deposited through the BDP. On September 1, 2006, clients will receive different interest rates based on their relationship with Smith Barney. Generally, the deposit account balances of clients in higher interest rate tiers will receive higher interest rates than deposit account balances of clients in lower interest rate tiers.

Affiliated Program Banks have set the interest rate to be equal to the current rate paid by the Smith Barney Cash Portfolio Money Market Fund (SBCX). On September 1, 2006, ***interest rates will be established periodically by the Affiliated Program Banks based on prevailing economic and business conditions.*** It is the intention of the Affiliated Program Banks to continue to set the interest rate equal to the Smith Barney Cash Money Market Fund rate for those with assets "greater than $1 million" rate tier (i.e., the highest tier). The Affiliated Program Banks reserve the right to change this practice at any time. For the remaining tiers, the interest rates will be established periodically at levels that are expected to be lower than the highest tier. Please note that for clients in the "$250,000 to $499,999.999" and the "Less than $250,000" tiers, the interest rates are likely to be significantly lower than the interest rate paid to the "$1,000,000 or greater" tier.

The following interest rate tiers will become effective on September 1, 2006:

- $1,000,000 or greater in a Statement Consolidation Plus Relationship
- $500,000 to $999,999.99 in a Statement Consolidation Plus Relationship
- $250,000 to $499,999.99 in a Statement Consolidation Plus Relationship
- Less than $250,000 in a Statement Consolidation Plus Relationship

The change was also referred to at page 8, in a "Disclosure Statement" portion of the Q&A, which contained a substantively similar misleading partial disclosure.

194. The Q&A also disclosed that a tax-exempt money market sweep alternative would no longer be available to customers having under $250,000 in assets. For those customers, "BDP will now replace the tax-exempt money-market fund as your sweep option for all new available cash balances." (*Id.* at 4).

195. With respect to other alternatives, all that the Q&A disclosed (scattered in three locations) was the following:

> • If you are affected by this change, as an alternative to the BDP you may elect not to have your funds swept. ***In such case, you may purchase any available taxable or tax-exempt money market fund by placing an order with your Financial Advisor subject to the Investment minimums outlined in the fund's prospectus, which may be obtained by contacting your Financial Advisor. Please read the Prospectus carefully before investing.*** [p. 4]
>
> * * *
>
> Q1: If. I am no longer eligible for the tax-exempt money market fund sweep option, is there an alternative to the BDP as a sweep option?
>
> A1: No. You may choose to have no sweep option. Available cash balances will be automatically swept into an interest bearing sweep vehicle, but will remain as free cash balances and earn no interest unless you place a specific order with your Financial Adviser to purchase any available taxable or tax-exempt money market fund. [p. 6]
>
> * * *
>
> The Affiliated Program Banks are not obligated to pay different Interest rates on different tiers and interest rates on different tiers may be changed at any time without notice to you. The interest rates paid with respect to the Deposit Accounts may be higher or lower than the interest rates available to depositors making deposits directly with an Affiliated Program Bank or other depository institutions in comparable accounts. You should compare the terms, rates of return, required minimum mounts, charges and other featured of BDP with other deposit accounts and alternative Investments. [p. 10].

196. The statements in paragraphs 189-95 were materially false and misleading because, *inter alia*, they failed to disclose the amount of money clients would lose in the Bank Deposit Program from not having funds in money market accounts; they only justification for the Bank Deposit Program was for Smith Barney to increase already massive profits for 8% or

higher on clients' uninvested cash and that no *bona fide* "Financial Advisor' would even establish this program for their clients.

197. The Q&A made the following qualified partial disclosure about the "***benefits***" to Smith Barney of the cash sweep program (at p. 12):

> **Compensation and Benefit to Smith Barney and Citigroup**
>
> Smith Barney will receive a fee from each Affiliated Program Bank of up to one half of one percent of the average daily deposit balance held by the Affiliated Program Bank in Deposit Accounts established by Smith Barney at the Affiliated Program Bank. The amount of the fee may vary from Affiliated Program Bank to Affiliated Program Bank, and Smith Barney has the right to waive all or part of this fee. A portion of Smith Barney's fee will be shared with your Financial Advisor. Other than applicable fees Imposed by Smith Barney on brokerage accounts, there will be no charge, fee or commission imposed on your account with respect to BDP.
>
> BDP creates financial benefits to Citigroup, Inc. and one or more of its subsidiaries. The Affiliated Program Banks may use the cash balances in their Deposit Accounts to fund certain lending activity. As with other depository institutions, the profitability of the Affiliated Program Banks is determined in large part by the difference between the Interest paid and other costs incurred by them on the Deposit Accounts, and the interest or other income earned on their loans, investments and other assets. The income (i.e., "spread") that the Affiliated Program Banks will have the opportunity to earn through their lending activity is usually significantly greater than the fees earned by Citigroup Global Markets Inc., or its affiliates, from distributing the Smith Barney Money Fund Portfolios. Deposits in Deposit Accounts at Affiliated Program Banks provide a stable source of lendable funds for the Affiliated Program Banks.
>
> You may obtain information about your Deposit Accounts, including balances, the current Interest rate and the names and priority of the other Affiliated Program Banks at which Deposit Accounts are currently available by contacting your Financial Advisor.

198. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to disclose any estimate of the massive dollar amount or percentage yields Smith Barney earned or expected to earn from the use of its clients' uninvested cash. A

disclosure of Smith Barney's billions in profit or 8% or higher yield on their clients' uninvested cash would have put the lie to Smith Barney's well touted role as a "Financial Advisor."

199. Smith Barney also ensured that its financial representatives received compensation for sweeping clients' cash into inappropriate affiliated bank and lower interest bearing bank accounts. As set forth above in paragraph 197 (and paragraph 206, *infra*), Smith Barney states: "[a] *portion of Smith Barney's fee will be shared with your Financial Advisor.*" (Emphasis added).

c. Smith Barney "FMA" Agreement" False And Misleading Claims That The Bank Deposit Program "Allow[s] Idle Cash [To Be] Invested Automatically"

200. To open a new account at Smith Barney, a client must submit an "Account Application, Client Agreement and Substitute Form W-9 Request for Taxpayer Identification Number" (the "Account Application"). With respect to sweep funds, the Account Application provides as follows:

Sweep Fund ***Sweep allows your idle cash to be Invested automatically.*** Choose where you would like your cash to be invested. Please check one. *The FMA account has a daily sweep.*	□ Bank Deposit Program℠ – ***FDIC insured deposits in affiliated Citigroup banks*** (note: not available for managed accounts or business accounts) □ Tax-free money market fund □ Money market fund (subject to eligibility rules in the *Sweep Features* section of the Important New Account Information materials)

(Emphasis added).

201. The "Important New Account Information" booklet referred to in the Account Application is 65 pages. Disclosures about the sweeps program are also contained in a two page "Bank Deposit Program (BDP) Disclosure Statement" (the "Disclosure Statement"), which, as set forth below, contains substantively identical disclosures.

202. In the "Disclosure Statement" section of the "Important New Account Information" document (at pp. 10 and 12-13), Smith Barney makes the following statements about the availability of the sweep program:

> Subject to account eligibility requirements, cash balances in your account (from securities transactions, dividend and interest payments as well as other activities) are automatically deposited, or "swept" into interest-bearing FDIC-insured deposit accounts ("Deposit Accounts") in up to three depository institutions ("Program Banks"). Your funds will be deposited in Deposit Accounts at the three Program Banks in the following order: Citibank (South Dakota), N.A., Citicorp Trust Bank, FSB, and Citibank, N.A. until your funds reach $98,500. Once your funds reach the limit at the third Program Bank, additional funds will be placed in Citibank (South Dakota), N.A. without limit. You may at any time designate any Program Bank except Citibank (South Dakota), N.A. as ineligible to receive your funds.
>
> * * *
>
> The specifics of the sweep and its impact on your account will depend on the type(s) of account(s) you maintain with us.
>
> 1. Each time that you have qualifying cash of at least $100 in your **basic** Smith Barney securities account as of the close of business every Friday or the business day prior to the last day of your statement reporting period, and you currently maintain or within the prior 12 months maintained a minimum investment of $1,000 in a Smith Barney money market fund, in Deposit Accounts through the BDP or have a combined value of qualifying cash and Smith Barney money market funds, Deposit Accounts or savings deposit balances of at least $1,000, ***Smith Barney will sweep all qualifying cash into the investments described above on the following business day.*** Smith Barney® Reserved clients, and Private Wealth Management accounts are exempt from the requirement to maintain or to have maintained within the prior 12 months a $1,000 minimum investment in a Smith Barney money market fund or in Deposit Accounts through the BDP feature.
>
> 2. ***Based on balances in your FMA***, FMA PLUS, Business FMA, International FMA, Smith Barney® Reserved clients and Private Wealth Management accounts and certain managed money accounts as of the close of business each business day, ***Smith Barney will sweep all qualifying cash of $1 or more into the Deposit*** Accounts established on your behalf through the BDP feature ***or into the available Smith Barney money market fund you have chosen on the following business day.***
>
> 3. In the case of IRAs, as of the close of business each business day, Smith Barney will sweep all qualifying cash of $0.01 or more into the Deposit

Accounts established on your behalf through the BDP feature or the Smith Barney money market fund of your choice on the following business day.

(Emphasis added).

203. Both the "Bank Deposit Program (BDP)" section of the "Important New Account Information" document (at pp. 10 and 12-13) and the BDP Disclosure Summary, contain the following statement about the payment of interest in the sweep program and the availability of sweep alternatives:

Interest

You will be paid interest on your Deposit Accounts based upon interest rate tiers. Within each interest rate tier the same interest rate will be paid. Interest rates will be established periodically by the Affiliated Program Banks based on prevailing economic and business conditions. It is the intention of the Affiliated Program Banks to continue to set the interest rate equal to the Smith Barney Cash Portfolio Money Market Fund rate for the "greater than $1 million" rate tier (i.e., the highest tier). The Affiliated Program Banks reserve the right to change this practice at any time. For the remaining tiers, the interest rates will be established periodically at levels that are expected to be lower than the highest tier. You can obtain the current available interest rate tiers and interest rates by accessing the Smith Barney website at smithbarney.com or calling your Financial Advisor.

* * *

Interest Rate Tiers. Interest paid by the Affiliated Program Banks will be tiered based upon the value of eligible assets in accounts included in your Statement Consolidated Plus Relationship (see below). Generally, the Deposit Account balances of clients in higher interest rate tiers will receive higher interest rates than the Deposit Account balances of clients in the lower interest rate tiers.

The interest rate tiers as of September 1, 2006 are as follows:

- $1,000,000 or greater in a Statement Consolidation Plus Relationship
- $500,000 to $999,999.99 in a Statement Consolidation Plus Relationship
- $250,000 to $499,999.99 in a Statement Consolidation Plus Relationship
- Less than $250,000 in a Statement Consolidation Plus Relationship

The Affiliated Program Banks are not obligated to pay different interest rates on different tiers and interest rate tiers may be changed at any time without notice to you. The interest rates paid with respect to the Deposit Accounts may be higher or lower than the interest rates available to depositors making deposits directly with an Affiliated Program Bank or other depository institutions in comparable

accounts. ***You should compare the terms, rates of return, required minimum amounts, charges and other features of the Program with other deposit accounts and alternative investments.***

204. The descriptions of the cash sweep program in paragraphs 200-03 failed to disclose that losses to Bank Deposit Program customers from not having uninvested cash swept into money market fund and that the Bank Deposit Program was implemented solely for Smith Barney to profit and that *no bona fide* "Financial Advisor" would rig such a system which ensures profit to a Financial Advisor at their clients' expense.

205. With respect to the availability of a tax-free fund as a sweep account alternative, Smith Barney discloses in the "Important New Account Information" document (at p. 31) but not the BDP Disclosure Summary that:

> (b) SB Money Funds. As an alternative to the BDP, you may elect an available tax-exempt SB Money Fund as your sweep investment. If the amount of funds in your sweep account at a depository institution reaches the maximum amount that may be deposited through the BDP, you authorize us to sweep available cash into your chosen SB Money Fund. If you are not eligible to participate in the BDP [generally, foreign customers], you may elect an available SB Money Fund. You authorize us to automatically sweep cash balances into your chosen SB Money Fund. You represent that the prospectus for the SB Money Fund you have chosen has been made available to you.

Therefore, under the literal terms of the BDP Disclosure Summary, a tax-free money market alternative is available for new customers, but only ***after*** those customers had more than $98,500 in ***uninvested*** funds.[4] Since most customers having brokerage accounts would primarily own stocks or mutual funds rather than having cash, this requirement means that all except the wealthiest of customers maintain all or most of their cash through the bank sweep account feature.

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[4] The $98,500 amount was disclosed in a ***different*** section of the "New Account Information Document." (at p. 10). The pertinent disclosure is quoted in Paragraph 202, *supra*.

206. With respect to Smith Barney's compensation, Smith Barney made substantively similar discloses to those contained in its August 1, 2006 Notice in both the "New Account Information" booklet and BDP Disclosure Summary:

> **Compensation and Benefit to Smith Barney and Citigroup**
>
> We receive a fee from each Program Bank of not less than 47.3 basis points (0.473%) of the average daily deposit balance held by an Affiliated Program Bank in Deposit accounts established by Smith **Barney** at the Affiliated Program Banks and we may receive a significantly greater fee depending on the interest rate tier an account is placed into on a monthly basis. The amount of the fee may vary from Program Bank to Program Bank, and we have the right to waive all or part of this fee. A portion of our fee will be shared with your Financial Advisor. **Other than applicable fees on securities accounts, you will not be charged any fee or commission for participation in the BDP.**
>
> The program creates financial benefits to Citigroup Inc. and one or more of its subsidiaries. The Affiliated Program Banks may use the cash balances in their Deposit Accounts to fund certain lending activity. As with other depository institutions, the profitability of the Affiliated Program Banks is determined in large part by the difference between the interest paid and other costs incurred by them on the Deposit Accounts, and the interest or other income earned on their loans, investments and other assets. The income (i.e., "spread") that the Affiliated Program Banks will have the opportunity to earn through their lending activity is usually significantly greater than the fees earned by Citigroup Global Markets Inc., or its affiliates, from distributing the SB Money Fund portfolios. Deposits in Deposit Accounts provide a stable source of lendable funds for the Affiliated Program Banks.

(Emphasis in original)

207. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to disclose the *amount* by which Smith Barney and its affiliates profited from bank account sweeps and that the sweep system was rigged to pay clients less interest than money market funds in order to increase Smith Barney's and its affiliates' profits at its clients' expense.

9. Wachovia "Financial Advisor" Misrepresentations and Omissions

208. In a section of its "Investing" web page called "Why Choose Wachovia Securities?," Wachovia emphasizes the "help" Wachovia can provide in "creating an effective financial strategy that helps ensure your goals:"

> **Why Choose Wachovia Securities?**
> Because creating an effective financial strategy can help ensure that your goals become a reality. Whether you are planning for your own retirement, preparing to pay for a child's college tuition, or need guidance as the result of a major life event, Wachovia Securities can help.
> Learn More

209. The "Learn More" hyperlink leads to a "Why Choose Wachovia Securities?" web page, in which Wachovia emphasizes its "Integrity" and "Seasoned investment professionals" as two reasons why Wachovia can help you "manag[e] you investments and plans for tomorrow:"

> **Why choose Wachovia Securities?**
>
> ***Integrity. Seasoned investment professionals.***
>
> Those are just two reasons why Wachovia Securities may be an intelligent choice when you need help managing your investments and plans for tomorrow. Our Financial Advisors can provide you with customized advice on a regular or occasional basis—you simply choose the level of advice you prefer.
>
> Wachovia Securities provides a full array of brokerage and other financial services through more than 10,500 Financial Advisors, and 3,100 Wachovia Financial Centers and Wachovia Securities Direct personal brokers. We invite you to learn more about how we can help you realize your financial goals.
>
> Learn More About Investing with a Financial Advisor
>
> ***Find out how a Wachovia Securities Financial Advisor can help you better understand investment choices and adjust your portfolio as your situation or needs change.***

(Emphasis added).

210. On a "Life Event Planning" web page, Wachovia touts that its "Financial Advisors can help lead you where you want to go:"

> Life Event Planning
>
> Whether you are planning for college, a new career, marriage, or retirement, at Wachovia we realize that making decisions around these life events can be challenging. We have the tools to get you started, and ***our Wachovia Securities Financial Advisors can help lead you where you want to go.***

(Emphasis added).

211. On a web page entitled "Investment Choices," Wachovia emphasizes the significance of a customer relationship with a Financial Advisor:

> When you established ***a relationship with us***, you can choose from any of the investments offered – or ***work with an experienced Financial Advisor*** to build a customized portfolio that suits your investment style, objectives, time frame and risk tolerance.

(Emphasis added).

212. The benefits of investing with one its 10,500 Financial Advisors are touted on an "Invest With an Adviser" web page, where Wachovia represented to customers that:

> At Wachovia Securities, ***our Financial Advisors are committed to your financial welfare. They listen carefully and take a holistic approach that ties your financial objectives and needs directly to your life goals.*** As trained professionals, they have knowledge and resources to help you reach your financial goals.
>
> When you select a Wachovia Securities Financial Advisor, we realize you've chosen us over scores of alternatives in a highly competitive industry. ***As a firm, we'll work hard to continue to earn your trust each time we serve you.***

(Emphasis added).

213. A Wachovia "Our Advisory Process" web page describes a "Four-Step Process" to help investors achieve their goals:"

> **OUR ADVISORY PROCESS**

Most people agree that investment planning is the right thing to do. But sometimes it feels like an overwhelming task, and many of us never get started.

At Wachovia Securities, we make this process easy and flexible through a Four-Step Process:

Step 1: Understanding your goals
Gaining a clear understanding of your life goals is the first step in the advisory process. *We will spend time getting to know you, your interests, preferences and values. Once these are defined and your goals understood, together we can start developing an investment plan.*

Step 2: Developing a plan
We will work with you to create a customized investment plan to help you achieve your goals. The plan is built on a sound strategy that incorporates your needs, time horizon and risk tolerance.

Step 3: Implementing strategies
Once your plan is established, we will recommend tailored investment strategies. Together, we select from a broad array of products and services, and implement the strategies that make sense for you.

Step 4: Evaluating progress
Throughout our advisory relationship, we will communicate with you on a regular basis to assess your progress. Recommendations and strategies will be adjusted over time as needed to address your evolving goals and changes in the markets.

Get started today
Contact a Wachovia Securities Financial Advisor today to start the Four-Step Process and get your investment plan on track.

(Emphasis added).

214. On its "Brokerage Accounts" web page, Wachovia also touts its ability to provide "individualized advice and multiple choices" to its clients, and that that "we [Wachovia] stand ready to help you achieve those goals." The web page describes two different accounts – a "Full Service Brokerage" account and a "Self-Directed Brokerage" account, emphasizing for each account the availability of a Financial Advisor:

Get the best of both worlds.

Whether you prefer objective, thoughtful recommendations from one of our Financial Advisors, or decide to do you own investing, we encourage you to choose the type of relationship best suited for your needs.

Full-Service Brokerage (Apply Now)
A Full-Service Brokerage account provides you with complete asset management through an experienced Financial Advisor who is available for guidance by phone or at your Financial Center. However, choosing this option does not limit you to only broker-assisted trades. If you choose, you can also place your own trades through a Wachovia Securities Online Brokerage account.

Self-Directed Brokerage (Apply Now)
If you prefer to handle investment choices and transactions on your own, Wachovia Securities Direct allows you to do just that, online or over the phone. ***And should you feel like you need some help – perhaps to rebalance your portfolio or reevaluate investments after a life-changing event – you can always call and speak to a Wachovia Securities Direct broker.***

(Emphasis added).

215. Moreover, at its "Full-Service Brokerage" web page, Wachovia attempts to put its customers at ease, assuring them that they can spend more time with their family or pursue other interests "because your Wachovia Securities Financial Advisor is watching and helping to guide your investment portfolio:"

FULL-SERVICE BROKERAGE

Time. These days, it seems like a precious commodity. ***A Full-Service Brokerage account may give you more time with family, extra hours to build a business, or whatever it is you enjoy most – because your Wachovia Securities Financial Advisor is watching and helping to guide your investment portfolio.***

You can trust your Financial Advisor to provide you with customized, objective advice as well as help you build and manage your wealth through investment planning and tailored investment strategies. ***Your Financial Advisor works with you*** to create an appropriate investment portfolio – and helps ensure that it stays balanced with your objectives and risk tolerance.

* * *

Full-Service Features
Backed by the firm's market analysts and research sources, and with a diverse selection of accounts and services to choose from, ***your Financial Advisor has all***

the tools to provide you with a personalized plan to manage your assets. Full-Service includes:

- **Personal Financial Review**
  As the foundation of your plan, this review enables you to chart progress towards your goals, and is tailored to address your needs.

* * *

- **Portfolio Analysis**
  An on-going, four-step process that simplifies investing and ensures that the investment decisions you make support your long-term financial goals.

(Emphasis added; footnote omitted).

216. Additionally, Wachovia offers the "Command Asset Program," which purports to "simplify your finances," "eliminate confusion" and create a "relationship" whereby Wachovia's customers "receive personalized assistance from an experienced Wachovia Securities Financial Advisor" to "ensure that [their customers'] money is working to its full potential."

COMMAND ASSET PROGRAM

A world of benefits and opportunities awaits you with a Wachovia Securities Command Asset Program. ***Eliminate the confusion of multiple accounts at various institutions by integrating your investment and banking needs into a single relationship.*** Plus, ***you also receive personalized assistance from an experienced Wachovia Securities Financial Advisor***, who can help guide your investment decisions to help ***ensure that your money is working to its full potential.***

Command Asset Program Brokerage Features

- Advice from a Wachovia Securities Financial Advisor
- ***Daily sweep with competitive rate***
- Choice of Full-Service, Discount, or Online Brokerage service
- Margin loans
- Gain/loss reporting
- Investment research and stock quote line available 24 hours a day

(Emphasis added; footnote omitted).

217. Wachovia's web site also includes a "Client Commitment" web page which assures clients that Wachovia has their best interests at heart:

> *We believe that...*
> - ***It is critical to understand your total financial needs in order to help you achieve your life goals.***
> - ***Integrity and objectivity are essential to our relationship.***
> - ***A trusted relationship implies responsibilities for our firm, your Financial Advisor, and you.***
>
> **Our Commitment to You**
>
> *Prudent Investment Guidance*
> - ***You will be provided with prudent investment guidance and recommendations based on a thorough understanding of your goals, time horizon, risk tolerance, and financial situation.***
> - ***You will be informed of any significant conflict of interest, and we will always act in your best interest.***
> - You will have assistance in setting realistic expectations about the long-term performance and associated risks of various investments. Your Financial Advisor will present you with product and service alternatives based on your objectives and risk tolerance - and disclose the comparative risks, benefits, and costs.
>
> *Quality Service*
>
> - ***You will be treated in a fair, ethical, and respectful manner.***
> - You will receive competent, courteous, and responsive service.
> - You will have convenient access to your Financial Advisor and your account information.
>
> *Clear Reporting*
> - ***You will receive clear, accurate, easy-to-understand descriptions of all your transactions and other communications in addition to timely periodic statements of all your accounts....***

(Emphasis added).

218. Wachovia's misrepresentations to Plaintiffs and other members of the Class that Wachovia Financial Advisors have a special relationship of trust and integrity to their clients such that the client comes first were repeated hundreds of time in print, television and other media.

219. The statement in paragraphs 208-18, *supra*, were deceptively false and misleading because, *inter alia*, under the cash sweep program, Wachovia and its Financial Advisors did not, "earn your trust each time we serve you," or "always act in your best interest" – rather they worked for Wachovia's and their own profit; Wachovia did not act in the sweep program with the level of "trust" and "integrity" it had represented to its clients but rather as a competitor using client cash for its own profit; nor were Wachovia's "seasoned investment professionals and "tools" used to "ensure that [customers'] money is working to its full potential" in the sweep program.

220. Wachovia has also issued a Code of Conduct & Ethics, which is available from Wachovia's web site. Inside the front cover, which has the title, "Uncompromising Integrity," Wachovia Chairman and CEO, Ken Thompson addresses "Wachovia Teammates" with a letter, which states, in part:

> ***Wachovia is committed to uncompromising integrity. We do what we say. We communicate with candor. We admit our mistakes. We are people who take pride in our trustworthiness.***
>
> ***Integrity is key in action as well as intention.*** Wachovia has always operated under a code of conduct ...

(Emphasis added).

221. The next page within Wachovia's Code of Conduct & Ethics, sets forth "Wachovia's Values", which, include:

> INTEGRITY
> ***Trust and honesty are essential to us. We do what we say we will do. We communicate with candor.*** We admit our mistakes. ***We are people who can be trusted.***

(Emphasis added)

222. Finally, Wachovia's Code of Conduct & Ethics, state, in part, that Wachovia's ethical standards require "honesty and fair dealing" as well as "compliance with laws, rules and regulations," as follows:

> HONESTY AND FAIR DEALING
> ***Wachovia's ethical standards require honesty and fair dealing.*** We rely on these standards to gain the trust and admiration of customers, peers and stockholders.
>
> Wachovia, driven by a desire to excel, will compete by providing unparalleled customer service and innovative products and will not seek competitive advantage through unethical or illegal business practice. We will communicate with candor, and each employee, officer and director will endeavor to deal fairly with Wachovia's customers, vendors, competitors and employees. No employee, officer or director may take unfair advantage of another through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other intentional unfair-dealing practice. ***In short, we should do what we say we will do and must communicate honestly and ethically in serving our customers and conducting business with others.***
>
> Wachovia, and its employees, officers and directors, also must comply with all applicable antitrust and fair competition laws and regulations, and may not enter into arrangements with competitors to fix or control prices or engage in other prohibited activities. ***In addition, we must be aware of and follow the laws and Wachovia policies restricting conditioning or "tying"*** the price or ***availability of certain bank products to the customer's or prospective customer's purchase of additional non-traditional products or services.*** If you have any questions as to whether a particular action or activity may have the effect of restraining competition or on tying restrictions, you should contact Wachovia's Legal Division.

(Emphasis added).

223. Wachovia's cash sweep program violated its "Code of Conduct & Ethics," in that billions of dollars of its clients' uninvested cash were automatically swept – not into higher yielding money market accounts – but into affiliated bank accounts so that Wachovia was able to use its clients' uninvested cash for ***its own profit***, while paying its clients (presently) as little as 1%. Additionally, in violation of the Code, Wachovia's bank sweep program constitutes an illegal "tying" arrangement in violation of the federal antitrust laws.

10. Wachovia's False and Misleading Sweep Disclosures

224. Wachovia introduced its FDIC-insured sweep product to its brokerage customers in the fourth quarter of 2003. Based on disclosures made in Wachovia's 2004 Form 10-K, deposit balances related to the Sweep Program totaled $11.8 billion at year-end 2003 (which in actuality was just the 4th quarter of 2003). Wachovia quickly captured approximately $25.0 billion in new bank deposits, with most of the cash being pulled from Evergreen Investment Management Co. LLC, a corporate affiliate of Wachovia, and Prudential Financial, Inc. money-market funds.

225. The bank sweep program quickly became a major source of income for Wachovia. In an October 15, 2004 conference call with analysts, Bob Kelly, Senior Executive Vice President touted the success of Wachovia's bank sweep program as follows:

> Net interest income increased largely due to our continuing growth in the FDIC insured sweep account. Fee and other income is down due to lower trading activity. ... ***You can see the average core deposits are circle at 29 billion. Most of that is the FDIC insured sweep accounts.*** And I'd probably draw your attention to total assets under management at $249 billion is up about 4% over last year. If you back out the impact of the FDIC insured sweep accounts it's up, it's up about 10% year-over-year.

226. Wachovia reported at 2004 year-end, in its Form 10-K, that "Assets under management also include deposit balances related to the FDIC-insured sweep product, which grew to $29.9 billion compared with $11.8 billion at year-end 2003, contributing to net interest income growth." However, the similar specific disclosures of deposits *directly* related to the bank sweep program were noticeably missing from Wachovia's 2005 and 2005 Form 10-K filings, respectively.

227. Beginning January 23, 2006, recognizing that it could squeeze more profit from its clients' uninvested cash, Wachovia followed the lead of Merrill Lynch, Schwab, Morgan

Stanley and Smith Barney, and began paying a tiered rate on its bank deposit sweep accounts. However, unlike the others, not only did Wachovia provide a lower interest rate to customers with less assets, it also paid its standard brokerage account customers a lower rate of return than "Command Asset" brokerage account customers with the same amount of household assets. As reported in *Investment News*, on February 13, 2006, Wachovia "clients with less than $100,000 in assets who also had Wachovia's central asset Command account, the interest rate last week was 1.2%. These same clients without a "Command Asset" account were getting 1%." The same article continued: "[t]he rates tier higher as household asset levels rise, to a maximum last week of 3.68% for investors with $5 million or more in assets who have a Command account."

228. Wachovia's tiers in its Bank Sweep are structured based on customer assets as follows: $0 - $99,999; $100,000 - $249,999; $250,000 - $999,999; $1 million - $4,999,999; $5 million +. Each successive tier pays a higher annual percentage yield on uninvested cash swept into the Wachovia Sweep Banks. Additionally, as set forth in the preceding paragraph, Command Asset account customers receive a higher rate of return than standard brokerage account customers with the exact same amount of assets. For those customers who were eligible to have their uninvested cash swept into money market funds, Wachovia offered six municipal money market funds.

229. On June 1, 2007, in an article in The Wall Street Journal entitled "Wachovia Takes on Street", reporting on Wachovia's June 30, 2007 announcement that it would acquire A.G. Edwards Inc. for $6.95 billion, making Wachovia "one of the country's biggest brokerage houses," G. Kennedy Edwards, Wachovia's chairman and chief executive, announced that he plans to use Wachovia's cash sweep program to boost A.G. Edwards brokers' productivity:

> Mr. Thompson said he plans to boost the Edwards brokers' productivity, partly by shifting more client cash from money-market funds into its own insured bank

accounts, ***where customers often get low rates but Wachovia can reinvest the funds more profitably.***

(Emphasis added.)

a. Wachovia's Description of the "Bank Deposit Sweep Option"

230. Wachovia provides its customers with a seven-page "Cash Sweep Program Disclosure Statement," which purports to inform customers as to Wachovia's cash sweep program. Wachovia touted that the cash sweep program "automatically swept" uninvested cash balances – "for which no interest is otherwise earned or paid" – into an interest-bearing deposit account ... or, if available, money market funds" until the cash was invested or otherwise needed. That Statement is linked, *inter alia*, to Wachovia's "Why Choose Wachovia Securities," "Accounts and Services," "Asset Management Accounts," "Command Assets Program" and "Online Brokerage" web pages.

231. The Cash Sweep Program Disclosure Statement states that eligibility for each available Cash Sweep Option (*i.e.*, bank deposit or money market funds) "is determined by account type and can be obtained from your Financial Advisor." In particular, the following disclosures are scattered throughout the statement:

> The available sweep options currently consist of one or more money market mutual funds and/or an interest-bearing deposit account at Wachovia Bank. Wachovia Bank and the investment managers for the money market mutual funds are affiliated with us. ***Eligibility for each available sweep option is determined by account type.***
>
> * * *
>
> ***Eligibility for each available Cash Sweep Option is determined by account type and can be obtained from your Financial Advisor.*** The Money Market Funds offered in the Sweep Program consist exclusively of those for which an affiliate of Wachovia Securities provides investment management and other services, including the Evergreen Money Market Funds. Prior to, or at the same time your available funds are first swept into an eligible Money Market Fund, you will be furnished with the appropriate prospectus, which should be read carefully. The Bank Deposit Sweep Option consists of an interest bearing deposit account at

Wachovia Bank, N.A. ("Wachovia Bank"), an affiliate of Wachovia Securities. Further information regarding the Bank Deposit Sweep Option is contained below in the section entitled, Additional Information Regarding the Bank Deposit Sweep Option.

* * *

If you decide to enroll in a new product or service that doesn't offer your current Cash Sweep Option, your new Cash Sweep Option will become the Bank Deposit Sweep Option if you are eligible (if not, your Cash Sweep Option will be an available Money Market Fund selected by us) unless you select a different available Cash Sweep Option.

* * *

Certain Clients and Accounts Ineligible
The Bank Deposit Sweep Option is currently limited to individuals, certain non-profit organizations, fiduciaries and trusts, provided that the beneficiaries are individuals or otherwise eligible. Accounts in the name of business entities, including corporations, limited liability corporations and partnerships, are not eligible for the Bank Deposit Sweep Option. Certain non-profit corporations are also not eligible, as well as clients with ERISA or IRA accounts participating in any of our investment advisory programs or accounts held by government entities. Any ineligible account with the Bank Deposit Sweep Option, and any balance therein, will automatically be moved to an available taxable Money Market Fund selected by us without prior notice.

(Emphasis added).

232. A slightly different version of the Cash Sweep Program Disclosure Statement is linked only through a "Legal Disclosures" web page at Wachovia's web site – and therefore is unlikely to be seen by investors.[5] That version contains substantially the same language, except that it adds the highlighted language making it clear that only individual investors with a Command Asset brokerage account have a money market sweep option:

> ***For standard brokerage accounts, the Bank Deposit Sweep Option serves as the exclusive Cash Sweep Option for eligible clients.*** The Bank Deposit Sweep Option consists of an interest-bearing deposit account at Wachovia Bank, N.A. ("Wachovia Bank"), an affiliate of Wachovia Securities. Further information

[5] This version contains the following file identifier on the bottom left-hand corner: "578329 (Rev 1)." The version linked through Wachovia's investment account web pages is version "578329".

> regarding the Bank Deposit Sweep Option, including eligibility requirements, is contained below in the section entitled, *Additional Information Regarding the Bank Deposit Sweep Option. **For Command Asset Program accounts, the Cash Sweep Option will be the Bank Sweep Deposit Option for eligible clients unless you choose one of the available tax-advantaged Money Market Funds.***

(Emphasis added).

233. Therefore, the Cash Sweep Program Disclosure Statement that investors are most likely to see is silent as to ***which*** specific individual accounts provide a money market alternative to the Bank Deposit program. Thus, absent speaking with a Financial Advisor, Wachovia customers are in the dark as to which Cash Sweep Options are available for their accounts.

234. For those accounts (*i.e.*, individual accounts) for which the "Bank Deposit Sweep Option" is available, the Program Disclosure Statement states that it is used by default:

> ***If you do not select a Cash Sweep Option when you open your account, or you select an ineligible Cash Sweep Option, your Cash Sweep Option will be the Bank Deposit Sweep Option*** if you are eligible (if not, your Cash Sweep Option will be an available Money Market Fund selected by us). If you wish to specify a different ***available*** Cash Sweep Option, you may do so at any time by contacting us. Existing balances in your prior Cash Sweep Option will be automatically transferred to the new Cash Sweep Option you select.

(Emphasis added).

235. Contrary to Wachovia's representation to customers that their Financial Advisors "ensure that [customers'] money is working to its full potential," in the Cash Sweep Program Disclosure Statement, under the heading "Rates of Return," Wachovia attempts to disavow itself of its fiduciary duties and obligations to its customers. With respect to tiers and the interest rate paid, and alternative investments to for customers, the Wachovia Cash Sweep Program Disclosure Statement states as follows:

> **Rate of Return**

The rate of return for the sweep options vary over time. Current rates can be obtained from your Financial Advisor, by calling the general inquiries phone number listed on the front of your account statement, or found on our website at www.wachoviasec.com for clients with online account access.

- The rate of return on the Bank Deposit Sweep Option is set by Wachovia Bank, which may seek to pay as low a rate as possible consistent with its views of competitive necessities. The rate will be tiered based upon account type and the overall household value of your account(s) with Wachovia Securities.

- Money market mutual funds seek to achieve the highest rate of return (less fees and expenses) consistent with prudence and their investment objectives.

- There is no guarantee that the yield on any particular cash sweep option will remain higher than others over any given period. The rate of return on any of our sweep options may be lower than that of similar investments offered outside of the Cash Sweep Program.

* * *

Wachovia Bank does not have a duty to provide the highest rates prudently available and may instead seek to pay as low a rate consistent with its views of competitive necessities. Lower rates may be more financially beneficial to Wachovia Corporation and its affiliates, including Wachovia Bank and Wachovia Securities, and their respective personnel. There is no necessary linkage between bank rates of interest and the highest rates available in the market, including any money market mutual fund rates. By comparison, a Money Market Fund generally seeks to achieve the highest rate of return (less fees and expenses) consistent with the fund's investment objective, which can be found in the fund's prospectus. (Money Market Fund rates may, however, be impacted by the fees imposed by the particular class of shares selected by us for the Sweep Program.)

236. Therefore, notwithstanding Wachovia's repeated statements, for example, that "[y]ou can trust your financial advisor;" that "our Financial Advisors are committed to your financial welfare;" that Wachovia's Financial Advisors "ensure that [customers'] money is working to its full potential," and that the sweep program offers a "[d]aily sweep with competitive rate;" Wachovia in the Sweep Program Disclosure ***disclaims*** any obligations to its customers to provide a meaningful interest rate and seeks to replace Wachovia's fiduciary duties with *caveat emptor*.

237. Wachovia further back-peddles from its representations to customers that "your Wachovia Securities Financial Advisor is watching and helping to guide your investment portfolio" and – despite Wachovia's contrary duplicative disclosure and lack of immediate publicly available information – puts the onus on individuals to monitor their cash sweep option and to determine other alternatives. The Cash Sweep Program Disclosure Statement provides, in part:

> **Duty to Monitor**
> You must monitor and determine the best sweep option for you under this program. You may also elect not to participate in the Cash Sweep Program and instead periodically invest cash balances in other investments.
>
> * * *
>
> **Your Responsibility to Monitor Your Cash Sweep Option**
> As returns on the Cash Sweep Options, your personal financial circumstances and other factors change, it may be in your financial interest to change your Cash Sweep Option or invest cash balances in products offered outside of the Sweep Program consistent with your investment objectives and risk tolerance. ***Wachovia Securities does not have any duty to monitor the Cash Sweep Option for your account or make recommendations about, or changes to, the Sweep Program that might be beneficial to you.***

(Emphasis added).

238. The statements in paragraphs 230-37, *supra*, were deceptively false and misleading since, *inter alia*, it was not disclosed that no *bona fide* unconflicted "Financial Advisor" would permit the placement of uninvested cash in low interest bearing bank accounts instead of in money market funds and that the only justification for doing so was for Wachovia to reap billions of dollars in profit from commercially lending and investing its clients' uninvested cash for Wachovia's own profit.

b. <u>Wachovia's "Alternatives" To The Sweep Program</u>

239. Wachovia purports to provide "alternatives" for its customers as follows:

Alternatives to the Sweep Program

> You may elect not to participate in the Sweep Program and/or periodically invest cash balances directly in available money market mutual funds or other products offered as direct investments outside of the Sweep Program by providing instructions to your Financial Advisor. Please note if you elect not to participate in the Sweep Program, accruing cash balances will not earn a rate of return prior to direct investment. In addition, available cash will not be automatically swept into any money market mutual fund or other investment that you purchase outside of the Sweep Program.

240. The statements in the preceding paragraph are materially false and misleading; because, for many individual customers (*i.e.*, those not in the Command Asset" program), the only real sweep alternative was to receive no interest at all on the customer's uninvested cash balances. Further, it would be futile to consult a Wachovia "Financial Advisor" about the program since he or she was incented to have the money sweep into the bank accounts.

c. "Administrative Fees" and "Benefits to Wachovia Securities And Others" Under The Sweep Program

241. Wachovia's web site is linked to a document entitled "Investment Service Group; Schedule of Fees (Effective January 1, 2007)." Wachovia charges – "in addition to any brokerage fees" – an Annual Fee of $125 (which is waived for accounts with $250,000 or more in household assets) and a Monthly Service Fee of $30 (the monthly fee is waived for customers who maintain a minimum balance of $25,000). For a "basic" Brokerage Account, Wachovia charges an Annual Fee of $60 (which is also waived for accounts with $250,000 or more in household assets).

242. The "Cash Sweep Program Disclosure Statement" purports to describe the "benefits" to Wachovia under the Sweep Program:

> **Benefits to Wachovia Securities and Others**
> ***Wachovia Securities and its affiliates receive fees and benefits for services provided in connection with the Sweep Program, and we may choose to make available the Cash Sweep Options that are more profitable to us and our affiliates than other money market mutual funds or bank deposit accounts. A portion of these fees may be paid to your Financial Advisor.*** Wachovia

Securities and its affiliates may receive distribution (Rule 12b-1), investment management, service fees and other compensation as a result of sweeping available cash into the Money Market Funds. These fees, which vary depending on the Money Market Fund (and class thereof) used, are paid directly by the Money Market Funds but ultimately borne by you as a shareholder in the fund.

Wachovia Securities and its affiliates, including Wachovia Bank, benefit financially from cash balances held in the Bank Deposit Sweep Option as well. Wachovia Bank earns net income from the difference between the interest it pays on deposit accounts, such as the Bank Deposit Sweep Option, and the income it earns on loans, investments and other assets. As noted above, Wachovia Bank may pay rates of interest on the Bank Deposit Sweep Option that are lower than prevailing market interest rates. ***Wachovia Securities may receive fees and compensation of up to two percent (2.0%) from Wachovia Bank and/or its affiliates based on the average monthly deposit balances in the Bank Deposit Sweep Option (computed on an annualized basis).*** This compensation is subject to change and we may waive all or any part of this fee at any time without notice. In addition, certain executives of Wachovia Securities may receive incentive compensation based in part on the profitability of the Bank Deposit Sweep Option for Wachovia Bank and their joint parent company, Wachovia Corporation. We shall also receive a benefit by retaining any interest earned (generally at the Federal Funds rate) on cash balances awaiting disbursement or prior to such balances being swept into your Cash Sweep Option. ***In addition, Evergreen Investment Management Company, LLC, a corporate affiliate of Wachovia Securities, may receive compensation of up to 0.35% from Wachovia Corporation and 0.09% from Wachovia Securities of the average monthly deposit balances in the Bank Deposit Sweep Option that originate through Wachovia Securities Financial Advisors (computed on an annualized basis). As a result of the fees and benefits described above, the Bank Deposit Sweep Option may be significantly more profitable to us than other available Cash Sweep Options.***

Prudential Financial, Inc. and certain of its affiliates ("Prudential Financial") also benefit financially from balances held in the Cash Sweep Options in addition to its 38% ownership in Wachovia Securities' parent company, Wachovia Securities Financial Holdings, LLC. ***Prudential Financial may receive up to 0.25% directly from Wachovia Corporation based on the average monthly balances (computed on an annualized basis) in Bank Deposit Sweep Option balances and Evergreen Money Market Funds for legacy Prudential Securities clients.***

(Emphasis added).

243. The statements in the preceding paragraph were materially false and misleading since, *inter alia*, they failed to meaningfully disclose the true benefits to Wachovia of its Cash

Sweep Program by quantifying Wachovia's massive profits in terms of the percentage yield from commercial lending or investing of 8% or higher and the absolute dollar amount in terms of hundreds of millions of dollars.

244. Wachovia also ensured that its Financial Advisors received compensation for sweeping clients' cash into inappropriate affiliated bank and lower interest bearing bank accounts. As set forth above in paragraph 242, Wachovia states: "*A portion of these fees may be paid to your Financial Advisor.*" (Emphasis added).

d. Wachovia's Deceptive Description Of Bank Deposit FDIC-Insured Option

245. In the Cash Sweep Program Disclosure Statement, in the "Additional Information Regarding the Bank Deposit Sweep Option" section, Wachovia downplays the "Differences Between the Bank Deposit Sweep Option and Money Market Funds" emphasizing that money market funds are not FDIC insured:

> **Differences Between the Bank Deposit Sweep Option and Money Market Funds**
> The Money Market Funds available as Cash Sweep Options are registered with the SEC pursuant to the Investment Company Act of 1940. The Bank Deposit Sweep Option consists of an interest-bearing deposit account at Wachovia Bank, which is regulated by the Office of the Comptroller of the Currency under various federal banking laws and regulations. ***Deposits in the Bank Deposit Sweep Option are eligible for FDIC insurance as described above.*** The Money Market Funds purchase high quality, short-term securities in seeking to maintain their net asset value of one dollar per share. ***There is no guarantee that this net asset value per share will always be maintained and you may lose money by investing in Money Market Funds. Funds invested in a Money Market Fund are not guaranteed or insured by the FDIC or any other government agency and are not deposits of a bank or bank affiliate, including Wachovia Bank.***

(Emphasis added).

246. The statements in the preceding paragraph, *supra*, are false and deceptive since, *inter alia*, as any unconflicted "Financial Advisor" is aware, the FDIC insured feature of the Defendant bank accounts in no way justifies placing client uninvested cash in such low interest

bearing accounts since money market funds pose no meaningfully greater risk justifying the significantly lower yield to the client.

FIRST CLAIM

Violation of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 et seq.

247. Plaintiffs repeat and reallege the allegations as set forth above as if set forth fully herein.

248. Each of the Brokerage Defendants is an investment adviser under the Investment Advisers Act, 15 U.S.C. § 80b-1 *et seq.*, who entered into express, implied or assumed cash sweep contracts with Plaintiffs and other members of the Class. Defendants for compensation engage in the business of advising Plaintiffs and other members of the Class, either directly or through publications or writings, as to the value of "securities" or as to the advisability of investing in, purchasing, or selling "securities" as defined at 15 U.S.C. § 80b-2(11).

249. The provision of bank sweep account services is not incidental to the conduct of their business and Defendants receive special compensation therefore. This compensation includes but is not limited to (a) the Brokerage Defendants' annual or monthly fees to their customers for "CMA" Accounts, "Schwab One" accounts, "FMA" Accounts, "Active Assets" accounts, and Wachovia standard and Command accounts;[6] and (b) the percentage fees paid to the Brokerage Defendants by their affiliated banks for the providing those banks with customer cash sweeps.

250. Under the Investment Advisers Act, Defendants, as Investment Advisers, owed to Plaintiffs and other members of the Class a fiduciary duty to fully and fairly disclose to all

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[6] Prior to October 2005, Schwab waived account service fees for Schwab One accounts with more than $25,000. In October 2005, Schwab stopped charging clients account service fees. Wachovia currently waives account service fees for assets greater than $250,000.

conflicts of interest and all material facts, and an affirmative obligation to employ reasonable care to avoid misleading clients.

251. In breach of their fiduciary duties to Plaintiffs and other members of the Class in violation of the Investment Adviser Act, Defendants made the above-described misrepresentations, concealment and omissions of material facts concerning their actions as "Financial Advisors" to customers, their cash sweeping practices and their tiered tactics, thereby deceiving Plaintiffs and other members of the Class with full knowledge that they were false and misleading and that the customers' cash balances were being reinvested for their profits at the customers' expense.

252. As a result of Defendants' fiduciary duty breaches, each of the Brokerage Defendants' bank sweep account agreements with Plaintiffs and other members of the Class are void under Section 15 of the Investment Advisers Act, 15 U.S.C. § 80b-15(b), which provides:

> Every contract made in violation of any provision of this title and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this title, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision.

253. Each of the Parent Corporation Defendants and Sweep Bank Defendants acquired rights under and was benefited by their affiliated brokerage firm's bank account sweep agreements and had actual knowledge of the conduct engaged in by the Brokerage Defendants that made those agreements in violation of the Investment Advisers Act.

254. In addition to seeking a declaratory judgment that the sweep account agreements with the Class are void, Plaintiffs seek an accounting and restitution on behalf of the Class of all

monies and fees wrongfully obtained by Defendants and their affiliates pursuant to the bank sweep account program, and disgorgement of all profits made by the Brokerage Defendants and their affiliates due to their conduct in violation of the Investment Advisers Act.

SECOND CLAIM

Violation of the New York General Business Law § 349

255. Plaintiffs repeat and reallege the allegations as set forth above as if set forth fully herein.

256. Section 349 of the New York's General Business Law states:

> Deceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state are hereby declared unlawful.

257. As set forth above, Defendants deceptive, acts, practices, and the false representations and omissions made by Defendants to Plaintiffs and the other Class members concerning their brokerage accounts and cash balances were prepared and disseminated from New York in the course of conducting their business, trade and services in New York, including but not limited to all of the statements made in Bank Deposit Program Disclosure Statements, monthly brokerage statements and other public statements. Defendants' statements, omissions and deceptive scheme, directed at consumers, misled Plaintiffs and other Class members. Defendants' misrepresentations and omissions were likely to mislead reasonable consumers acting reasonably under the circumstances.

258. Defendants' conduct and actions, as described above, constitute deceptive business practices in violation of the GBL.

259. The damages sustained by Plaintiffs and the other Class members were a direct and foreseeable result of, and were proximately caused by Defendants' deceptive business practices.

260. As a result of Defendants' actions, Plaintiffs and other Class members have been injured and damaged in an amount to be determined at trial.

THIRD CLAIM

Common Law Fraud

261. Plaintiffs repeat and reallege the allegations as set forth above as if set forth fully herein.

262. The above described conduct and actions constitute common law fraud by way of misrepresentations, concealment and omissions of material facts made by Defendants.

263. Defendants made the above-described misrepresentations, concealment and omissions of material facts which they had the duty to disclosure concerning their actions as "Financial Advisors" to customers, their cash sweeping practices and their tiered tactics, with full knowledge and/or reckless disregard that they were false and misleading and that the customers' cash balances were being reinvested for their profits at the customers' expense.

264. Defendants intended that the Plaintiffs and the other Class members relied upon the above-described misrepresentations, concealment and omissions.

265. Defendants' misrepresentations and omissions concerning the brokerage accounts, including the cash sweeping practices, were material in Plaintiffs' and the other Class member's decision to open and maintain a brokerage account with Defendants, and to maintain monies in bank sweep accounts.

266. Plaintiffs and other Class members justifiably relied upon such misrepresentations, concealment and omissions to their damage and detriment.

267. The damages sustained by Plaintiffs and the other Class members were a direct and foreseeable result of, and were proximately caused by, Defendants' misrepresentations, concealment and omissions.

268. As a result of Defendants' actions, Plaintiffs and the other Class members have been damaged and injured in an amount to be determined at trial.

269. Defendants' conduct was willful, wanton, and reckless. Based on the intentionally dishonest nature of Defendants' conduct, which was directed at the Class and at the public generally, Defendants should also be held liable to the Class for punitive damages in an amount to be determined at trial.

FOURTH CLAIM

Breach of Contract
(against the Brokerage Defendants)

270. Plaintiff repeats and reiterates the allegations set forth above as though fully set forth herein.

271. There is an implied covenant of good faith and fair dealing inherent in the Brokerage Defendants' contractual relationships with Plaintiffs and other Class members. Among the Brokerage Defendants' obligations to their customers were to act in their interests in taking discretionary actions with their accounts, to make full and complete representations about their dealings with their customers, and not to appropriate Plaintiffs' and the Class's funds in order for the Brokerage Defendants to unjustly enrich themselves and their affiliates at Plaintiffs' and the Class's expense.

272. Also, each of the Brokerage Defendants' account agreements with Plaintiffs and other Class members were and are subject to and governed in part by the NYSE and NASD rules and regulations. Indeed, the Merrill Lynch CMA Disclosures explicitly state that:

> ***CMA and Beyond Banking accounts are governed by the rules and regulations of*** the Securities and Exchange Commission (SEC), the Federal Reserve System, ***the New York Stock Exchange (NYSE), the State of New York, and the National Association of Securities Dealers (NASD)***, as well as Merrill Lynch's own policies and procedures.

(Emphasis added).

273. By placing Plaintiffs' and the Class' uninvested monies into bank sweep accounts at substantially below money market rates, by making the misrepresentations and omissions set forth herein, by unilaterally using "negative consent" to modify the terms of bank sweep programs to advantage themselves to the detriments of their customers, and by violating the NYSE and NASD rules and regulations set forth at paragraphs 20-21, 72-74, *supra*, the Brokerage Defendants breached their contractual relations with Plaintiffs and other Class members, including their implied covenant of good faith and fair dealing.

274. The damages sustained by Plaintiffs and the other Class members were a direct and foreseeable result of, and were proximately caused by, Defendants' misrepresentations, concealment and omissions.

275. As a result of Defendants' actions, Plaintiffs and the other Class members have been damaged and injured in an amount to be determined at trial.

276. The Brokerage Defendants' conduct was willful, wanton, and reckless. Based on the intentionally dishonest nature of the Brokerage Defendants' conduct, which was directed at the Class and at the public generally, the Brokerage Defendants should be held liable to Plaintiffs and other Class members for actual damages as well as punitive damages in an amount to be determined at trial.

FIFTH CLAIM

Breach of Fiduciary Duty

277. Plaintiffs repeat and reiterate the allegations as set forth above as if set forth fully herein.

278. The Defendants, through their agents and representatives, held themselves out as financial advisors to Plaintiffs and other Class members, and as such owed fiduciary duties to Plaintiffs and the other Class members. The Defendants participated in a false and deceptive scheme which violated their fiduciary duties of loyalty and fair dealing owed to Plaintiffs and the Class by causing Plaintiffs and Class members' uninvested cash to be placed in low interest bearing bank accounts at Defendants' affiliated banks, even though such investments were wholly unsuitable under the NASD rules and failed to represent best execution under the rules, and were done solely in order to enhance their own profits at the Plaintiffs; and the Class' expense. The Defendants also violated their fiduciary duties of full and complete disclosure in that the investment was unsuitable for Plaintiffs and the Class and of all conflicts of interest regarding financial transaction which they initiate such as the cash sweep transactions.

279. As fiduciaries, the Defendants their agents and representatives owed to Plaintiffs and other Class members the duties of good faith, fair dealing, due care and loyalty in connection with their management and use of Plaintiffs' and the Class's funds, and also the duty to disclose all material facts which might reasonably affect Plaintiffs' and the Class' investment decisions, including any interest or benefit the Brokerage Defendants receive in a transaction where they are serving their clients.

280. In breach of their fiduciary duties to Plaintiffs and other Class members, the Defendants made the above-described misrepresentations, concealment and omissions of

material facts concerning their actions as "Financial Advisers" to customers, their cash sweeping practices and their tiered tactics, with full knowledge that they were false and misleading and that the customers' cash balances were being reinvested for their profits at the customers' expense, all in violation of NASD and NYSE rules.

281. In breach of their fiduciary duties to Plaintiffs and other Class members, the Defendants transferred the Brokerage Defendants' clients' uninvested funds into bank sweep accounts for the Defendants' own use and benefit and unilaterally used the "negative consent" to modify the terms of Cash Sweep Programs to promote their own advantage, to the detriment, rather than for the benefit, of Plaintiffs and other Class members. The Sweep Bank Defendants permitted and participated in such diversion of funds from their clients.

282. Alternatively, the Brokerage Defendants, in placing Plaintiffs' and the Class' money into low-interest paying sweep accounts, acted as the agents and at the control and direction of the Parent Corporation Defendants and Sweep Bank Defendants, and the Parent Corporation Defendants and Sweep Bank Defendants are liable therefore. The Parent Corporation Defendants and Sweep Bank Defendants, with full knowledge of the Brokerage Defendants' scheme, directly benefited from the bank sweep arrangements to Plaintiffs' and the Class' detriment.

283. The damages sustained by Plaintiffs and other Class members were a direct and foreseeable result, and were proximately caused by, Defendants' breaches of their fiduciary duties.

284. As a result of the Defendants' actions, Plaintiffs and the other Class members have been damaged and injured, and the Defendants including the brokerage banking and corporate defendants have been unjustly benefited, in an amount to be determined at trial.

285. The Defendants' conduct was willful, wanton, and reckless. Based on the intentionally dishonest nature of the Defendants' conduct, which was directed at the Class and at the public generally, the Defendants should also be held liable to the Class for punitive damages, in an amount to be determined at trial.

SIXTH CLAIM

Aiding and Abetting Breach of Fiduciary Duty
(against the Parent Corporation and Bank Sweep Defendants)

286. Plaintiffs repeat and reiterate the allegations as set forth above as if set forth fully herein.

287. As set forth above, the Brokerage Defendants breached their fiduciary duties to Plaintiffs and the Class.

288. Each of the Parent Corporation Defendants and Bank Sweep Defendants, for its financial benefit, knew of, knowingly induced or participated in, permitted, and provided substantial assistance to, the fiduciary breaches by its affiliated Brokerage Defendant by, *inter alia*, orchestrating and directing the bank account sweep set forth above, arranging for itself (for the Bank Sweep Defendants) or its affiliated Bank Sweep Defendants (for the Parent Corporation Defendants) to be used for bank sweep accounts, and reviewing and approving or ratifying both the bank sweep programs adopted by its subsidiary Brokerage Defendant and the disclosures made by that subsidiary concerning the bank sweep program and brokerage accounts.

289. The damages sustained by Plaintiffs and the Class were a direct and foreseeable result of, and were proximately caused by, the Parent Corporation Defendants' and the Bank Sweep Defendants' aiding and abetting conduct.

290. As a result of the Parent Corporation Defendants' and Bank Sweep Defendants' actions, Plaintiffs and the other members of the Class have been damaged and injured, and the

Parent Corporation Defendants the Bank Sweep Defendants and their subsidiaries have been unjustly benefited, in an amount to be determined at trial.

291. The Parent Corporation Defendants' and Bank Sweep Defendants' conduct was willful, wanton, and reckless. Based on the intentionally dishonest nature of the Parent Defendants' and Bank Sweep Defendants' conduct, which was directed at the Class and at the public generally, the Parent Corporation Defendants and Bank Sweep Defendants should also be held liable to the Class for punitive damages in an amount to be determined at trial.

SEVENTH CLAIM

Negligence
(against the Brokerage Defendants)

292. Plaintiffs repeat and reiterate the allegations as set forth above as if set forth fully herein.

293. The Brokerage Defendants owed to Plaintiffs and other Class members a duty of care concerning Defendants' deployment of "sweep" monies and concerning the advice and information given by Defendants regarding bank sweep accounts and other alternatives.

294. The Brokerage Defendants breached their duty of care, *inter alia*, by placing Plaintiffs' and the Class' uninvested monies into bank sweep accounts at substantially below money market rates, by making the misrepresentations and omissions set forth herein, by unilaterally using "negative consent" to modify the terms of Cash Sweep Programs to promote their own advantage to the detriment of their clients, and by violating the NYSE and NASD rules and regulations set forth at paragraphs 20-21, 72-74, *supra*, including the NYSE and NASD rules concerning communications, and the NYSE "know thy customer" and NASD "suitability" rules.

295. The Brokerage Defendants' conduct as described herein was, at minimum, negligent.

296. The damages sustained by Plaintiffs and the other Class members were a direct and foreseeable result of, and were proximately caused by, Defendants' breaches of their duty and negligent conduct.

297. As a result of the Brokerage Defendants' actions, Plaintiffs and the other Class members have been damaged and injured, in an amount to be determined at trial

EIGTH CLAIM

Unjust Enrichment

298. Plaintiffs repeat and reallege the allegations as set forth above as if set forth fully herein.

299. Plaintiffs and the other Class members entered into contracts with the Brokerage Defendants to open and maintain brokerage accounts with one or more of the Brokerage Defendants.

300. Throughout the Class Period, the Defendants, by arranging to put the customers' cash into low interest paying deposit accounts at Defendants' bank affiliates, generated higher interest profits for their affiliates.

301. Defendants have been unjustly enriched at the expense of and to the detriment of Plaintiffs and each member of the Class by collecting money to which they are not entitled. Specifically, by reinvesting the customers' cash at higher rates while paying the customers the lowest rates, Defendants used the investors' funds for the profit of themselves and their affiliates, and thus yielded enormous ill-gotten profits.

302. Defendants should be required to disgorge this unjust enrichment.

NINTH CLAIM

Negligent Misrepresentation

303. Plaintiffs repeat and reallege the allegations as set forth above as if set forth fully herein.

304. Defendants' above-described misrepresentations, concealment and omissions of material facts concerning their actions as "Financial Advisors" to customers, their cash sweeping practices and their tiered tactics were false and misleading, in violation of their duties to Plaintiffs and the Class.

305. Defendants were negligent in making the above-described misrepresentations, concealment and omissions of material facts.

306. Defendants' misrepresentations and omissions concerning the brokerage accounts, including the cash sweeping practices, were material in Plaintiffs' and the other Class member's decision to open and maintain a brokerage account with Defendants, and to maintain monies in bank sweep accounts.

307. Plaintiffs and other Class members justifiably relied upon such misrepresentations, concealment and omissions to their damage and detriment.

308. The damages sustained by Plaintiffs and the other Class members were a direct and foreseeable result of, and were proximately caused by, Defendants' misrepresentations, concealment and omissions.

309. As a result of Defendants' actions, Plaintiffs and the other Class members have been damaged and injured in an amount to be determined at trial.

TENTH CLAIM

Violation of the Sherman Antitrust Act 15 U.S.C. § 1

310. Plaintiffs repeat and reallege the allegations as set forth above as if set forth fully herein.

311. Section 1 of the Sherman Act, 15 U.S.C. §1, provides:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal.

312. This provision precludes, *inter alia*, tying arrangements where a seller exploits its control or market power over the sale of one product or service (*i.e.*, the "tying product") in one market (the "tying market") in order to force or coerce a buyer to purchase a separate and distinct product or service (*i.e.*, the "tied product"), which the buyer did not want at all or would have preferred to purchase elsewhere.

313. Here, Defendants exercised their dominant market power over consumers seeking to open *brokerage accounts* primarily for the purpose of buying and selling publicly traded securities and mutual funds (*i.e.*, the tying product), so as to coerce Plaintiffs and other members of the Class into placing their uninvested cash into Defendants' banks, and more specifically into *artificially low interest-bearing bank accounts* (*i.e.*, the tied product) at Defendants' banks. Thus, for example even though major national banks, such as Citibank, N.A. and JPMorgan Chase Bank, N.A., offered depositors savings accounts paying *over 4% interest*, Class Members at Merrill Lynch with assets of less than $250,000 were and are compelled to have their uninvested cash swept into bank accounts at the Merrill Lynch Sweep Banks only paying interest of approximately *1.3%* (as of 4/23/2007); for Class Members at Charles Schwab with assets of less than $100,000, their uninvested cash was and is forcibly swept into bank

accounts at Schwab Sweep Banks only paying interest of approximately *0.985%* (as of 2/21/2007); for Class members at Morgan Stanley with assets of less than $100,000, their uninvested cash was and is forcibly swept into bank accounts at Morgan Stanley Sweep Banks only paying interest of approximately *1.25%* (as of 2/21/2007); for Class Members at Smith Barney with assets of less than $250,000, their uninvested cash was and is forcibly swept into bank accounts at Smith Barney Sweep Banks only paying interest of approximately *1.42%* (as of 3/19/2007); and for Class members at Wachovia with assets of less than $250,000, their uninvested cash was and is forcibly swept into bank accounts at Wachovia Sweep Banks only paying interest of less than *1.15%* (as of 5/14/2007).

314. The tying brokerage account and the tied low interest-bearing banking account are two separate products, because the character of and demand for these two products are very different in the eyes of consumers. Consumers, including Plaintiffs and other Class members, turned to and continue to turn to brokerage firms, and to open brokerage accounts, primarily because it is through such firms and accounts that they may purchase publicly traded securities including common stock and bonds. Such publicly traded securities may not be purchased except through broker dealers such as the Brokerage Defendants who are licensed by the NASD. The primary goal of securities investment from the perspective of the consumer is to seek appreciation in market value.

315. In contrast, consumers look to banking institutions and bank accounts for very different purposes. Banks primarily offer lending services in the context of residential and commercial loans and mortgages, as well as FDIC insured savings and checking accounts and certificates of deposits. The principal purpose of checking and savings accounts is, in addition to providing access to funds for payment of expenses, to preserve capital while receiving a

competitive interest rate over a specified period of time. Bank services and products are demanded by consumers and offered by seller banking institutions entirely separate from brokerage services and products. Moreover, the tied bank product by Defendants imposed on Plaintiffs and other Class members – those paying extremely low rates of interest – was in no way an integral or necessary component of the brokerage account. The existence of preferable alternative bank accounts is reflected in the fact that clients with over $1 million in assets, for example, were offered by all Defendants higher yielding investments as a sweep alternative to the bank sweep account imposed on clients with lesser assets.

316. The Defendants' programs were *coercive*, because the Plaintiffs and other members of the Class were *required* to have their uninvested cash swept *only* into the low interest-bearing accounts offered by Defendants. The coercive nature of the cash sweep programs was clearly reflected in the fact that Plaintiffs and other Class members with lesser assets were given *no* sweep alternative. While certain Defendants touted the fact that their clients could opt out, in fact "opting out" meant choosing to receive *no* interest on their uninvested cash, which of course was effectively offering no alternative at all.

317. Defendants had, and exercised, significant *market power* in the tying brokerage market, such that the implementation of the cash sweep programs had anticompetitive effects in the tied product market. By almost any metric, the Brokerage Defendants are among the top ten brokerage firms, exercising control of a very substantial portion of the brokerage market. In a June 2004 report on the U.S. Securities Industry issued by Snapshots International Ltd., just ***three of the five*** defendants – Morgan Stanley (24.1%); Merrill Lynch (19.2%); and Charles Schwab (3.0%) – were found to hold approximately ***46.3%*** market share of the U.S. Securities Industry in 2003.

318. Additionally, the U.S. securities brokerage market, which is defined as "*establishments that provide services related to buying and selling of securities for a fee or a commission*," has been estimated by RocSearch Ltd. as of the year-ended December 31, 2005 to be approximately *$3.2 trillion dollars*. Defendants' filings with the SEC for the year ended December 29, 2006 contained information approximating the dollar amount of client assets held by each firm. These figures underscored defendants' enormous market power in the U.S. brokerage industry. As reflected in Merrill Lynch's Form 10-K for the year-ended December 29, 2006, there were approximately 2.3 million individual investor CMA accounts at Merrill Lynch with aggregate assets of approximately $770 billion. As reflected in Schwab's Form 10-K for the year-ended December 31, 2006, there were 6.7 million active brokerage accounts at Schwab and total "Schwab Investor Services" assets of $670.9 billion. As reflected in Morgan Stanley's Form 10-K for the year-ended November 30, 2006, total client assets (excluding corporate/other) at Morgan Stanley were $686 billion. Currently, Smith Barney represents on its website, on a web page entitled "About Citi" that there are 7.5 million client accounts at Smith Barney representing nearly $900 billion in client assets. And, as reflected in Wachovia's Form 10-K for the year ended December 31, 2006, Wachovia had $760 billion of "total broker client assets" (excluding A.G. Edwards, Inc.). RocSearch recognized specifically in the same study the significant leading competitive position in the U.S. brokerage market of Defendants Merrill Lynch, Morgan Stanley and Citigroup.

319. Brokerage firms offer different forms of brokerage accounts, including "separate account programs," where the investment advisor is paid an annual fee for all securities transactions, as well as brokerage accounts where the financial advisor is compensated per each securities trade or transaction. Cerulli Associates analyzed the market share of U.S. brokerage

firms along three criteria: "separate accounts," "separate account managers" and "managed accounts." "Separate Accounts" are defined as programs by which asset managers manage investors' assets in discretionary separate accounts typically with minimums of $100,000 or more, while "managed accounts" encompass all fee-based advisory programs offered typically by larger brokerage firms. "Separate Account Managers" are responsible for managing or providing advisory services in connection with the Separate Accounts. While these measures only encompass a portion of the Class (since they exclude brokerage accounts where the financial advisor is not given discretion, which are also part of the Class herein), as reported on December 19, 2005 by Cerulli Associates in the *Market Share Reporter*, the Defendants held ***68.7%*** or $443.8 billion of the total $646 billion Separate Account Program market with Smith Barney holding a 28.3% market share; Merrill Lynch holding a 22.1% market share; Morgan Stanley holding a 9.3% market share; Wachovia holding a 5.5% market share (excluding A.G. Edwards, Inc.); and Schwab holding a 3.5% market share. On January 13, 2005, the *Market Share Reporter* analyzed the market for "Separate Account Managers" and reported that the same defendants held ***66.9%*** of the market as follows: Defendant Smith Barney represented 32.8% of the market; Merrill Lynch represented 23.5% of the market; Morgan Stanley represented 8.2% of the market; Schwab represented 2.4% of the market; and Wachovia represented 1.9% of the market (excluding A.G. Edwards, Inc.). On October 31, 2005, the *Market Share Reporter* also reported Cerulli Associates data on the "Managed Account" market and reported that Defendants Merrill Lynch, Smith Barney and Wachovia (excluding A.G. Edwards, Inc.) represent 20.8%, 20.1% and 6.7% of that market, respectively.

320. Defendants' dominant market share is also reflected in a December 20, 2006 article published by The Economist Intelligence Unit Ltd., set forth the top ten broker/dealers by

dollar amount of capital. The report found total capital of the top ten broker/dealers was $182.47 billion. Defendants Morgan Stanley, Merrill Lynch, Citigroup Global Markets and Schwab – only four of the five defendants – represent *52%* of the total capital of the top ten broker/dealers: Morgan Stanley with approximately $38.69 billion in capital – or 21%; Merrill Lynch with approximately $35.95 billion in capital – or 20%; Citigroup Capital Markets (*i.e.*, Smith Barney) with approximately $16.53 billion in capital – or 9%; and Charles Schwab with approximately $4.5 billion in capital – or 2%.

321. Defendants' dominant market share is also reflected in the Securities Industry Yearbook 2006-2007, published by the Securities Industry Association., set forth the top fifty securities firms by number broker/dealer registered representatives ("RRs"). The top ten securities firms had approximately 86,101 RRs. Defendants all ranked in the top ten and represent approximately 72% of the total RRs employed by the top ten securities firms: Wachovia Securities (including A.G. Edwards, Inc.) with approximately 16,987 – or 19.7%; Merrill Lynch with approximately 16,480 RRs – or 19.1%; Smith Barney with approximately 12,782 RRs – or 14.8%; Morgan Stanley with approximately 9,526 RRs – or 11.1%; and Charles Schwab with approximately 5,796 RRs – or 6.7%.

322. Defendants' dominant market share is also reflected in a 2007 report by the Insurance Information Institute, which determined that the total revenue for the top ten U.S. securities firms in 2006 was approximately $300.61 billion. Again, three of the five defendants – Morgan Stanley, Merrill Lynch, and Charles Schwab – were included in the top ten U.S. securities firms when ranked by total revenues. Further, taking into account the total revenues of all five defendant securities firms, the Defendants' combined revenues constitute approximately

$168.72 billion – or *56%* of the $300.61 billion of revenue derived by the top ten U.S. securities firms.

323. The market power of Defendants is also reflected in the fact that they could impose bank account interest, as low as less than 1%, on Plaintiffs and other Class members, which were well below the interest rates which Plaintiffs and other Class members could have obtained at major banks for comparable savings accounts, had they not been subjected to Defendants' unlawful tying arrangements.

324. The market power of Defendants is further accentuated by the fact that Defendants appear to have purposely implemented largely *identical* cash sweep programs, thus further diminishing the alternatives available to the Plaintiffs and other Class members. The essential characteristics of all the programs were that they offered no sweep alternative to clients with lesser assets (other than receiving no interest at all on uninvested cash) and provided artificially low interest rates for the use of the clients' cash. Defendants' actions in implementing the cash sweep programs is reflected in news articles, in which Defendants sought to justify their anticompetitive practices and massive cash grab as the result of their allegedly needing to keep up with competition. In fact, major broker/dealers, such as Fidelity Investments, rejected such automatic sweep programs into bank accounts. Instead, Fidelity Investments permitted its customers to have their cash swept into a range of money market funds. Nevertheless, *The Wall Street Journal* reported on January 27, 2007 that Smith Barney finally disregarded the concerns of its prior CEO that the cash sweep program "hurt clients" and implemented the program because it "couldn't afford to pass up the profits and risk being left at a competitive disadvantage." Similarly, as reported in *Investment News* on December 12, 2005, when Morgan Stanley announced implementation of its cash sweep program, some of its brokers

described it as "very much a profit deal for Morgan Stanley," which "'scam[s] money' from clients" and "is not consistent with the strategy of offering the best products at the best price."

325. Defendants' coercive cash sweep programs have had a number of serious anticompetitive effects. The clearest and most significant anticompetitive effect of their programs was to provide Plaintiffs and other Class members with an artificially low interest amount on the cash swept into Defendants' bank accounts, and to foreclose Plaintiffs from the opportunity to obtain higher, competitive interest rates from the Defendants or their competitors. Instead, the Defendants enjoyed inflated profits from the coerced use of their clients' cash at the Plaintiffs' expense.

326. Defendants' coercive practices also had anti competitive effects on the tied banking market, since they permitted and permit Defendants to rapidly establish multi-billion banks with the assets of captive brokerage firm clients, thereby avoiding the substantial borrowing and marketing costs which competitive commercial banks are normally required to expend in order to first obtain depositors and then convince those depositors to place their funds in interest bearing bank accounts. *See* ¶¶ 70-71, *supra*; ¶ 327, *infra*. The anti competitive effects of Defendants' coercive tying arrangements in the tied banking market are reflected in the artificially low efficiency ratios of sweep banks. *See* ¶ 69, *supra*.

327. Defendants' tying arrangement have affected a substantial amount of interstate commerce. As reported on November 22, 2004 in an *America's Intelligence Wire* news article, Bank Sweep accounts in 2004 totaled $350 billion, and they have increased substantially since that time. Defendants' Sweep Bank holdings as of December 31, 2006 were approximately $186.25 billion. Schwab's bank sweep accounts were $4 billion as of December 31, 2004 and $10.65 billion as of December 31, 2006; Morgan Stanley's bank sweep accounts were $13.3

billion as of December 31, 2006; Smith Barney's bank sweeps account deposits (at Citibank South Dakota, N.A. – one of its sweep banks) were $645 million as of December 31, 2005 and $24.5 billion as of December 31, 2006; Merrill Lynch's deposit base was $66 billion as of December 31, 2004, and rose to $84.1 billion by December 31, 2006, $62.3 billion of which was attributed to Merrill Lynch's bank sweep accounts; and Wachovia's bank sweep accounts were $29.9 billion as of December 31, 2004 and $47.5 billion as of December 31, 2005. Indeed, the Merrill Lynch banks ***rank among the top 10 U.S. banks based on deposits.***

328. Plaintiffs and other Class members were injured in their business or property by reason of the Defendants' unlawful tying practices. The damages sustained by Plaintiffs and the other Class members were the direct, proximate and foreseeable result of Defendants' unlawful tying practices.

329. As a result of Defendants' actions, Plaintiffs and the other Class members have been damaged and injured in an amount to be determined at trial. The damages suffered by Plaintiffs and the other Class members as a result of Defendants' unlawful tying, in violation of 15 U.S.C. § 1, is an amount to be trebled pursuant to 15 U.S.C. § 15, and, under that statute, Plaintiffs are entitled to their reasonable costs, including attorneys' fees and costs.

WHEREFORE, Plaintiffs pray for relief and judgment, as follows:

(a) Determining that this action is a proper class action, and certifying Plaintiffs as class representatives under Rule 23 of the Federal Rules of Civil Procedure;

(b) Awarding compensatory, some of which is to be trebled, and punitive damages in favor of Plaintiffs and the other Class members against Defendants for all damages sustained as a result of Defendants' wrongdoing, in an amount to be determined at trial, including pre- and post-judgment interest thereon;

(c) Requiring Defendants to account for and/or pay in damages to Plaintiffs and other Class members the amounts by which Defendants benefited due to Defendants' wrongful conduct;

(d) Requiring Defendants to hold in constructive trust for the benefit the Plaintiffs and other Class members the monies obtained through the Defendants' fraudulent, unfair, and unconscionable conduct which caused Defendants to be unjustly enriched at the expense of the Plaintiffs and other Class members;

(e) Entering a Declaratory Judgment that Defendants' bank sweep account agreements with Plaintiffs and other Class members are void, and requiring restitution and disgorgement of all monies and profits obtained by Defendants or their affiliates pursuant to or as a result of the those agreements or the Cash Sweep Programs;

(f) Awarding Plaintiffs and other Class members their reasonable costs and expenses incurred in this action, including counsel fees and costs, and expert fees and costs; and

(g) Such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Plaintiffs hereby demand a trial by jury.

Dated: New York, New York
June 11, 2007

SCHOENGOLD SPORN LAITMAN & LOMETTI, P.C.
Samuel P. Sporn (SS-4444)
Joel P. Laitman (JL-8177)
Kurt Hunciker (KH-4190)
Jay P. Saltzman (JS-7335)
Ashley Kim (AK-0105)
Frank R. Schirripa (FS-1960)
19 Fulton Street, Suite 406
New York, NY 10038

Tel: (212) 964-0046
Fax: (212) 267-8137

Counsel for Plaintiffs and Proposed Putative Class

CERTIFICATE OF SERVICE

I, FRANK R. SCHIRRIPA, one of the counsel for Plaintiffs, hereby certify that on June 11, 2007, I filed the Second Amended Class Action Complaint with the Clerk of the Court, electronically mailed a copy to the Clerk of the Court and served a copy of said document by hand on the following:

Kenneth I. Schacter, Esq.
Theo J. Robins, Esq.
Bingham McCutchen LLP
399 Park Avenue
New York, NY 10022

Attorneys for Charles Schwab Defendants

Jay B. Kasner, Esq.
Scott D. Musoff, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP,
Four Times Square
New York, New York 10036

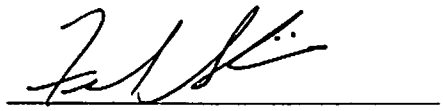
Attorneys for Merrill Lynch Defendants

A. Robert Pietrzak, Esq.
Dorothy J. Spenner, Esq.
Sidley Austin LLP
787 Seventh Avenue
New York, New York 10019

Attorneys for Citigroup Defendants

Bradley J. Butwin, Esq.
Daniel L. Cantor, Esq.
Allen W. Burton, Esq.
O'Melveny & Myers LLP
Times Square Tower
7 Times Square
New York, NY 10036

Attorneys for Morgan Stanley Defendants



Frank R. Schirripa