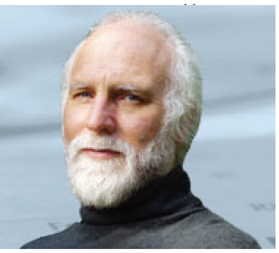
VOLUME 25, NUMBER 12 DECEMBER 2015

inside information



Edited/Published exclusively for leading financial professionals - www.bobveres.com

Auto-Cash Management

Synopsis: ***Would you like to give your clients an additional 1% a year (or more) on the cash that is earning nothing in their checking or money market accounts?***

Takeaways: ***The online banks are paying far more than bricks-and-mortar institutions on simple deposit accounts. Max My Interest automatically searches for the best rates, and (better yet) automatically ensures that the deposits are covered by the FDIC.***

While your clients are earning zero return on the cash portion of their portfolios, thousands of individuals are earning 100 basis points or more in ordinary savings accounts at online banks like GE Bank, Barclay's, Ally Bank, Capital One 360 and American Express Personal Savings—with full liquidity. In one case (GE Capital), the savings account rate is actually five basis points higher than the rate the bank is paying on its 12-month CDs.

Meanwhile, according to BankRate.com, the national average on all savings accounts is 10 basis points. The average money market account is paying 0.08%, and at least one institutional custodian is paying less than that, with a .45% expense ratio tacked on.

Okay, but what busy financial planner has the time and energy to shop for higher rates and stay on top of the cash holdings of 100 or 1,000 clients, while at the same time making sure that the money deposited in any one account never exceeds the $250,000 FDIC insurance limit? Is that additional 1% a year on a client's $1 million cash reserve worth your time and energy?

Probably not. But would you be interested in a service that automatically searches the web for the highest rates from a small group of reputable online banks, and every month positions just under $250,000 of client cash holdings into the highest-paying account account, and the next $250,000 at the next-highest interest rate, and so forth, automatically making sure that clients get the highest available rates offered in safe, insured accounts?

While you're at it, would you like every transfer to be transparent to the client, and have the service collect and send your client (and your client's accountant) the tax information on all interest collected from these various transfers at the end of each year?

This is the basic service proposition offered by a new company called Max My Interest (*www.MaxMyInterest.com*). "Because they don't have the expenses of brick-and-mortar locations, these online banks can offer much higher rates than you can get at the bank down the street," explains Gary Zimmerman, who founded the company after years of managing his own cash by hand. "It's an opportunity that anybody can access," he adds, "but I can tell you from personal experience that it can get pretty labor-intensive if you're trying to do it by hand."

Online damage control

Zimmerman woke up his own cash allocation only because he was forced to—when he faced an emergency in March 2009. As an investment banker with Citigroup in New York, he was reassigned to doing M&A work on location in Japan back in 2007. "I sold my apartment in New York and moved to Tokyo," he recalls. "As a result, I had a lot of cash in the company's bank, and one day I woke up and saw that Citigroup's stock had fallen to 97 cents a share. It struck me that if Citi did not survive the day, I would become an unsecured creditor of the bank."

What to do? Working with my spreadsheet, and, making sure that I was always FDIC insured, I would move the first dollars where the highest rates were being offered, and then into the next highest yielding bank and so on and so forth. As the rates changed each month, I would move things around all over again."

Consumer investors currently have $3.8 trillion in various cash accounts that earn zero or nearly-zero interest. Corporations are sitting on even more.

13 hours of time difference, and half a world of physical distance, Zimmerman saw no alternative but to move the proceeds of his apartment sale, remotely, to a cadre of online banks—a form of online damage control. "I got comfortable with how they worked, how the FDIC insurance limits worked with them [basically, the same as brick-and-mortar banks], and I spent the day opening online bank accounts," he says.

Along the way, Zimmerman discovered that the world of online banking was offering higher interest than he had seen in his own account, which is why they became his cash management solution after Citigroup ultimately survived. "Being somewhat detail-oriented, I had my own spreadsheet where I tracked everything on a monthly basis," Zimmerman adds. "Every month, I would log into each of these online banks, check my balance and notice how the rates had changed. I'd fill out

In 2010, Zimmerman looked at his spreadsheet and discovered that he had earned an extra $40,000 in incremental interest, compared with the near-zero earnings he would have collected at his bricks-and-mortar account.

"While that wasn't going to be a life-changing amount of money," says Zimmerman, "it struck me that all else being equal, I would be foolish not to do this. At the same time," he continues, "I also didn't want to spend any more time doing it. So I wondered whether there might be a way to automate the process that I was going through.

"Later," he continues, "it struck me that I probably wasn't the only person who had this problem. When I talked with my colleagues and some clients, many of them had $1 million or more sitting on the sidelines, earning nothing."

In fact, with a little research, Zimmerman discovered that consumer investors currently have roughly $3.8 trillion in various cash accounts that earn zero or very nearly zero interest. Corporations are sitting on even more cash.

Not only was effective cash management a real need in today's zero-interest rate economy; it affected a huge percentage of peoples' actual portfolio holdings.

Challenges and solutions

Zimmerman says that he faced two significant challenges in creating Max My Interest and reproducing his by-hand cash management process. "We had to not only automate it, but fully automate it," he says, "so that there is no human intervention at all, so it is entirely computer-controlled." It also needed to be a closed system, for security purposes. That means that the money would not be moving out to an advisor or client and back in to one or more of the online accounts; it would flow directly from and to the client's checking account to and from the online banks—period.

Zimmerman launched the company in September of 2014, but kept it quiet as he tested the system's reliability and functionality. The service today starts with a client's brick-and-mortar checking account, and it requires that your client have an account with one of five banks: JP Morgan Chase, Citibank, Wells Fargo, Bank of America and First Republic Bank—the banks with the most branch offices, plus First Republic because several of Zimmerman's first customers already had accounts there.

That checking account becomes the hub of the closed system. The client designates how large the balance should be in this account—and, as you'll see, this can be changed at any time. Any additional money above this designated amount is automatically swept into the Max My Interest process, and allocated into the aforementioned group of online banks.

For instance, suppose a client has $1 million in sleepy money in a checking account, and has decided that $25,000 would be the right amount of cash cushion for writing checks and covering automated bill payments. The remaining $975,000 is swept out and allocated into the online banks. The bank with the highest interest rate—which, when this article was written, happened to be GE Capital Bank, at 105 basis points—would receive the first $249,500 of excess cash. Yes, that's less than $250,000, because the system is attempting to keep the total balance, after interest is paid, below the $250,000 limit. The next $249,500 would be allocated to Barclay's Bank (100 basis points) followed by Ally Bank (100 basis points). The remaining $226,500 is swept into American Express Personal Savings (90 basis points).

Every month, on the 11th day of the month, Max My Interest will reoptimize. If American Express is now paying 115 basis points, it will get $249,500, and the remaining money will be distributed in a pecking order decided by the interest rates being paid by the other competing banks. Clients can go in and check what the system is planning, and they can reoptimize at any time by simply clicking on a button that says "reoptimize now."

Does that mean they could reoptimize daily? In the real world, no. "These transfers go by ACH [Automated Clearing House], so they take a few days to clear," Zimmerman explains. "The way the system is designed, if you do nothing, if you never come back to our website, once a month it will perform this optimization for you. And if you go to 'optimization history,' it will show you how your balances have progressed across the banks over time."

At any time, the client can decide to raise or lower the amount of cash that will be held in the bricks-and-mortar bank checking account, from $25,000 to $50,000, say, or down to $10,000, and this level of liquidity will be maintained until the system is told otherwise. And, Zimmerman points out one more time, this checking account is the only entry and exit point to/from the system. "Max My Interest is a closed system," he says. "There is no way to get money out of this system other than through your checking account."

The customer can designate how much should be maintained in the bricks-and-mortar bank checking account. Whenever there is more than that, it's automatically swept into the online accounts.

Automated account opening

How does a client open these online accounts and get started? Zimmerman says that it takes roughly ten minutes apiece for an individual to set up a savings account at any of the online banking institutions. But he decided to save Max My Interest customers even that hassle. "We developed something called the Common Application," he says, which basically means it now takes ten minutes to set up all five accounts.

"As it turns out," Zimmerman explains, "a lot of the data required

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to open an online bank account is common across multiple of these banks." So when your clients join the Max My Interest system, they're asked for their name, address, phone number and email, plus four or five additional questions that are common across all the bank accounts. "Then they can click the logos of the banks where they wish to open accounts," Zimmerman adds, "and Max prefills all the application forms for them. We don't ask you how much money you have. We don't ask you what you do. We don't ask you any of the typical questions that a financial advisor has to ask," he continues, "because we are not a financial advisor. We're not providing financial advice."

Your client gets an email from each bank, and he or she accepts the terms and conditions, and the accounts are open and waiting for the first deposit. Clients can then go into the Max My Interest website and select how much cash they want to maintain in their checking account, and they can also customize some other things. For instance, they can decide to exceed the FDIC limits and allocate some different amount to the highest-yielding and next-highest-yielding accounts—say, a maximum of $350,000 or $500,000—if they're comfortable that the online bank is going to remain solvent.

Zimmerman says that a couple can squeeze as much as $5 million under the FDIC limits with his current relationship with five online banks. How is that possible? "Anecdotally, we've had a number of advisors signing up clients for these larger sums," he says, "and the way they do that is, if it is a couple, they can have five accounts of $250,000 apiece in one person's name, and the same with the other. That's $2.5 million of coverage. And then they could open up joint accounts, where each person is insured up to $250,000, so that's an additional $500,000 per bank." Multiply that times five banks, and it comes to another $2.5 million. And this, too, can be automated.

"With our system, you can click on one button on our website, and it automatically retrieves all of your 1099s for those savings accounts."

How does a client keep track of the tax implications of all this? "We realized early-on that if a client has all these online accounts, it would be a bit of a pain for them to have to track down all of the 1099s," says Zimmerman. "With our system, you can click on one button on our website, and it automatically retrieves all of your 1099s for those savings accounts, compiles them into a single PDF, password protects it and sends it to you by email. You can forward it on to your accountant."

Cost? Eight basis points a year; which means two basis points billed out quarterly by Max My Interest for the service. No referral fees are collected from the banks themselves, although Zimmerman says he's been offered. "We wanted to focus purely on what's best for the client," he says. "If we started collecting these additional fees, then people would question: why did you choose this or that bank? We felt it was more important that our customers feel comfortable that we were solely focused on what was best for the individual investor."

Bankers' interest

Zimmerman expects to add more online banking institutions to the list, but he says the process is going slowly, mainly because he's being so choosy. "There are dozens of online banks in the country, but we have fairly high standards for who we'll include," he says. "We wanted to only include banks that have good customer service, a good user experience, and very investor-friendly policies. The banks must have no monthly fees, no cost per transaction and liberal transfer limits."

A number of banks, he says, are changing their policies so they'll meet these criteria. "It's fairly obvious why the online banks like this," Zimmerman says. "Most of them are currently paying a lot of money for customer acquisition; we don't charge them anything. About 20% of our customers have linked more than $1 million in cash," he adds. "What is interesting is that even the lowest-yielding of the banks in our system are attracting balances that are several multiples higher than their average balance across all of their other customers."

Max My Interest is also, to Zimmerman's surprise, attracting interest from the brick-and-mortar banks who are asking for their checking accounts to be included in the list of firms whose accounts qualify as the hub of the system. "Our initial expectation was that the checking account banks wouldn't be so thrilled by this," he says, "because our system effectively sweeps away cash from their accounts."

What he found, however, is that under the new Basil III liquidity requirements (technically the Liquidity Coverage Ratio), the banks are not interested in holding uninsured deposits because the new accounting rules penalize them. "Some of the banks have gone so far as to charge their best customers penalty rates for having money above the FDIC limit," says Zimmerman. "When they look at us, they see a stable source of deposits that are going to be maintained within their FDIC limits." Before long, Max My Interest will announce an expanded number of traditional banks whose checking accounts will be linked into the system.

What about the cash accounts of your corporate customers? Max My Interest has formed a partnership with American Deposit Management Company (*www.americandeposits.com*) in Delafield, WI, which offers a somewhat more expensive solution. "They're more of a classic deposit broker, with relationships with about 400 banks," says Zimmerman. "When a client comes to them, they literally parcel out funds in $250,000 packages, spreading it across a lot of banks. They're able to deliver about $40 million of FDIC insurance coverage per corporate entity," he adds. "But the yield on their system is lower than it would be through Max because they're using commercial accounts. But it's still a lot greater than zero, which is what most commercial accounts are earning."

"*With our system, you can click on one button on our website, and it automatically retrieves all of your 1099s for those savings accounts.*"

Security protections

Zimmerman says that his biggest challenge was building security into the Max My Interest system. "If you think about it, cash is the asset class where you have elected not to take risk," he says. "So when we built up our advisory board—which you can see on our website—we wanted to bring in experts who could help us with system security." It's a bit cumbersome to find these board members, but you can do it with one click here: *https://www.maxmyinterest.com/board-of-advisors*.

The list includes Harriet Pearson, an attorney with Hogan Lovells US, LLP in Washington, D.C., whose practice focuses on privacy and cybersecurity, and who also happens to lead a multi-industry group called the Working Group on Privacy and Cybersecurity. Another member of the board, Dr. Gary McGraw, is chief technology officer of the global software security consulting firm Cigital, Inc., also based in Washington, D.C, who writes a monthly security column for Information Security magazine.

"Cigital works with 16 of the 20 largest U.S. banking institutions," Zimmerman explains. "We brought in Dr. McGraw very early, first to advise us on overall system architecture, and then we brought in their chief cryptographer to advise on cryptography, to make sure that the methods we were using made sense. What we learned was that security has to be built into the code itself, into how you define variables, so you can prevent stack overflows and other possible vulnerabilities."

Beyond that, he says, all of

the transfers are made through ACH, which means if there is ever an unauthorized transfer, the client has 60 days to dispute it with the bank. "It's very similar to the rules around credit cards," Zimmerman says.

Macro-anomaly

When you look at the wide disparity between the most generous savings accounts and the industry norm, you encounter an interesting macro-anomaly that Zimmerman believes is rare in the investment world. "Most people have resigned themselves to the notion that cash is a zero return asset class, and so they just don't think about it," he says. "But the way I think about it is: if I had a mutual fund that was underperforming the market by 90 basis points every single year, year in, year out, it would be a one-star fund. But that," he continues, "is exactly what people are doing with $3.8 trillion in cash today—and that makes up 23.7% of high net worth portfolios. On an overall portfolio basis, this is about a 20 basis point drag on everyone's portfolio. Where else do you see such a big inefficiency?"

At the moment, Zimmerman actually doesn't know how many advisors are using Max My Interest, nor how many clients they have put into the system. "The way our system is designed today, it only interfaces with the end client," he says. "We have RIAs and private banks who tell us they're setting up their clients on this, but today the system is not set up to see the advisor."

That will change with a future iteration, where advisors will be able to sign up their clients and see their aggregated and individual cash balances on a single screen. "Right now, all I can say is that we know anecdotally that advisors are using this, from people we speak to," Zimmerman says.

Right now, it's hard for me to think of a more directly-useful service, at a more reasonable price, than Max My Interest. When I was first made aware of the system, I thought that advisors would have little interest, because their clients' cash was being closely managed. But when I compared notes with advisors at the NAPFA Fall conference in Indianapolis, I discovered that many of them had been looking for a way to wake up the large cash balances their clients were holding, and move the sleepy money to accounts that pay higher interest.

Max My Interest may not be something every client needs or wants. But for the subset who do, it could generate a nontrivial amount of additional return at with minimal time and effort on your part.■

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