September, 2013

Difference between a Registered Investment Advisor (RIA) and a Broker-Dealer

"You do not want anyone near your money- advisor or broker- whose compensation is tied in any way to their choice of investment vehicles"
– **William J. Bernstein**, American Financial Theorist

Seeking advice is essential in many aspects of life. The right advice can increase knowledge, save time, provide guidance in unknown areas, and reduce stress. This is especially true in the world of personal finance and investments.

There are two main business standards for personal investment advice and management. They are Registered Investment Advisors (RIAs) and Broker-Dealers. These are often thought to be the same or very similar practices, yet when examined there is an important difference that may not be fully understood by the individual investor. This difference is in the legal standards to which both parties are held. Investment Advisors are held to a "fiduciary standard" while Broker-Dealers have a "suitability obligation". Understanding these legal standards is a critical component for anyone seeking professional investment advice.

Let's take a look into the definitions, business models, and standards of both parties.

Broker-Dealers

A Broker-Dealer (BD) as defined in the California Corporations Code Section25004 is "*any person engaged in the business of effecting transactions in securities in this state for the account of others or for his own account*". A broker is a person who acts as an intermediary between a buyer and a seller, usually charging a commission. A dealer is person who is in the business of buying and selling securities. In general terms broker-dealers are persons that act as securities dealers or brokers or do both functions.

Broker-Dealer agents make the majority of their income through commissions from executing transactions for their customers. Some broker-dealers follow what is commonly referred to as an asset gathering business model, which is a strategy focused towards the process of gathering money to increase overall commissions and transactions. These broker-dealers train their representatives in personal sales tactics for the purpose of gathering assets.

Broker-Dealers are legally required to fulfill suitability obligations towards their clients. A suitability obligation is defined as making recommendations that are "suitable" and "appropriate" for their client. All recommendations at the minimum have to fall under the suitability obligation, but do not necessarily have to fall in line with the individual client's "best interests".

Registered Investment Advisors

Registered Investment Advisors (RIAs) are investment advisors that are registered within the state they operate or the SEC. An Investment Advisor is defined in the California Corporations Code Section 25009 as someone who for compensation engages in the business of investing in, purchasing, or selling securities. RIA's provide many services such as assisting individuals with retirement planning, or developing investment strategies for portfolios.

Registered Investment Advisors create income through services, and usually have a fee-based compensation structure based off a percentage of the assets they manage. All fees from an Investment Advisor must be in accordance to the consent given by the underling client.

Investment Advisors are held to a fiduciary standard that is in accordance with the Investment Advisors Act of 1940. A fiduciary is one of the highest legal standards and has roots back to Roman civil law. Someone acting as a fiduciary is expected to act in absolute loyalty to whom the duty is owed. The fiduciary must not place personal interests before their duty, and any revenues must be within the consent of the receiver. When applied to Investment Advisors, the fiduciary standard means that advisors are obligated to act in the best interests of their clients. They are to not have any conflicts of interest that would prevent them from placing their clients' interest above their own. Every action that an Investment Advisor makes is legally held to this standard, and all advice or trades must fully be aligned with the customer's best interests, goals, and risk tolerance.

The Breakdown

The business of investments is a critical aspect that all investors should know before they seek advice. How the difference between the suitability requirement and the fiduciary standard applies to your investments is valuable knowledge for anyone who is considering or currently has someone handling their money.

For example, a Broker/Dealer would be allowed to purchase an investment product for a client that would lead to increased commissions, as long as the investment is "suitable" for the customer there is no violation of the standard to which they are held. This can also give the brokers an incentive to sell their own investment products above other products that may come at a lower cost to their client. In contrast, a Registered Investment Advisor would be violating their fiduciary duty if any purchase led toward increased compensation.

For clients, the fiduciary standard has the clear advantage over the suitability obligation. Investment Advisors are held to this fiduciary standard under the federal securities law, yet this does not apply to all broker-dealers. Overall, it is best for an individual to find a money manager who will act in their best interests.

Investment Growth Management (IGM) is an independent Registered Investment Advisor (RIA) in the state of California. We are held to a fiduciary standard on behalf of our clients. IGM focuses on building and maintaining individual investment portfolios that are consistent to the best interests, goals, and risk tolerance of each client.

IGM can customize and manage a portfolio for you, or if you have questions, contact Michael Redlick at redlick@comcast.net or call 925-588-4743.

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