BROKER VS. INVESTMENT ADVISOR: WHAT ARE THE DIFFERENCES? WHY IS IT IMPORTANT TO YOU?

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Both brokers and investment advisors are licensed professionals who assist investors with their financial goals and objectives. Brokers are regulated by the Financial Industry Regulatory Authority (FINRA) while investment advisors are regulated by either the Securities and Exchange Commission (SEC) or their home state regulatory body, depending on the advisor's level of assets under management. Although their roles might seem similar to an outsider, investment advisors and brokers perform very different roles and provide very different types of services in the delivery of financial services to investors.

A BROKER is defined as any person engaged in the business of effecting transactions (buying and selling securities) for the account of others[1]. Despite having many different titles (ie. wealth manager, wealth advisor, investment consultant, financial advisor, financial consultant, and registered representative), brokers are generally not considered to have a fiduciary duty to their clients[2]. Instead of being required to put their client's best interests ahead of their own, brokers are expected to deal fairly with their clients and adhere to a lower standard of legal care known as the suitability standard[3]. This standard requires a broker to know his/her customer's financial situation well enough to recommend investments that are considered 'suitable' for that particular client[4]. In addition, brokers are not required to provide upfront disclosures like the ones required for investment advisors.

AN INVESTMENT ADVISOR operates quite differently from a broker and adheres to a stricter set of rules. An investment advisor is required to act in the best interest of his/her clients, putting the client's interests ahead of his/her own at all times[5]. This operating philosophy and legal requirement is called the fiduciary standard[6]. Under the fiduciary standard, an investment advisor must provide advice and investment recommendations that he/she views as being the best for the client. Fiduciaries must also adhere to the duties of loyalty and care[7]. Further, an investment advisor subject to the fiduciary standard is required to disclose all potential conflicts of interest to the client before entering into a contract for advisory services with that client[8]. As such, an investment advisor is legally prohibited from giving investment advice that may conflict with their client's needs.

As outlined above, there are significant differences with regard to industry rules, regulations and legal requirements in the way in which a broker delivers financial services to clients via the 'suitability standard' and the way in which an investment advisor delivers financial services to clients via the 'fiduciary standard'.

DUAL REGISTRATION & HYBRID MODEL: **Additional Investor Confusion**

The previous section reviews the major differences between the investment advisory (fiduciary) model and the brokerage (suitability) model. Further increasing the confusion for investors are the structures of 'dual registration' and the 'hybrid model'. Today, a large number of financial professionals serve as both investment advisors and brokers. As an example, an investor might open several accounts with a broker employed by one of the major brokerage firms (e.g., Merrill Lynch, Morgan Stanley, Wells Fargo, et al) or someone licensed with an independent broker/dealer (e.g., LPL Financial, Ameriprise, Cetera Advisors, et al). This broker (who usually has a different title that the firm allows him/her to use with the public) may sell the investor a fee-based/advisory account where the broker acts in the role of an investment advisor representative of the firm's advisory arm. The broker may also sell the investor other investment products where he/she earns a commission by acting in the role of a registered representative licensed with the firm's broker/dealer arm. In this scenario where the broker acts in the role of both investment advisor representative and registered representative, he/she is considered to be 'dually registered'. The 'hybrid model' is quite similar. In the 'hybrid model' the broker/advisor most often owns his/her independent registered investment advisory firm as opposed to being an employee of a brokerage firm.

One of the biggest potential issues for investors who are utilizing either a 'dually registered' or 'hybrid' model is that most often the lower legal standard of 'suitability', not the higher standard of 'fiduciary duty', applies to the relationship. This potential issue exists because the brokers at the major brokerage firms and/or at the independent broker/dealer firms can function as both an investment advisor and a broker in either the 'dually registered' or 'hybrid' models. As a result, determining if the financial professional is wearing the 'advisor hat' or the 'broker hat' is oftentimes very confusing for the investor.

COMPENSATION: **A Critical Component and Difference**

Investment advisors that operate on a fee-only basis (not 'fee-based') are compensated either by a fixed fee for their time or a percentage of the assets under management.

Brokers are compensated through commissions for the trades they place on behalf of their clients and/or the products they sell to their clients.

As described above, brokers who operate under a fee-based compensation arrangement within a 'dual-registration' or 'hybrid' structure can potentially earn compensation from fees paid directly by clients (similar to fee-only advisors) plus fees which they receive in the form of commissions from products they are licensed to sell.

Unlike investment advisors operating under a fiduciary standard, brokers are not required to inform their clients in detail how their compensation is earned. As such, the fee-based model may create significant potential conflicts of interest because the advisor's income is directly affected by the financial products, he/she sells to the client.

INDUSTRY MOMENTUM: **Investors are Beginning to Understand**

Over the last 10 plus years the investing public has become much more aware of the distinct differences between the broker/ sales model and the advisor/ fiduciary model. The investing public has been 'voting with their wallets' as they continue to choose the investment advisor model over the broker model. As a result, the U.S.'s largest brokerage firms have been steadily losing market share to independent investment advisors. According to the research firm Cerulli Associates assets managed by independent advisors have nearly tripled in the last decade, from $2 trillion to $5.7 trillion[9]. We believe this trend will continue.

INDUSTRY MOMENTUM: **Investors are Beginning to Understand** *continued*

The world of investment advice can be fraught with conflicts of interest, opaque disclosure and an overall lack of transparency. Seeking out an investment advisor who will act as your fiduciary can help to potentially eliminate many of the problems associated with the commission-driven, product-focused broker model. Because a fiduciary is required, by law, to give full and complete disclosure of how they are compensated as well as any potential conflicts of interest that may exist before doing business with any prospective client, the investing public is in a better position to make a more informed decision.

SUMMARY: **Where Does Round Table Stand?**

Since the founding of Round Table Wealth Management in 1999, the firm has always operated in a fiduciary capacity. Our client-centric approach to helping families and individuals achieve their financial goals and dreams has always put the client's interests ahead of our own. We strongly believe that, as a Registered Investment Advisor, it is not only the required way of serving clients from a legal perspective, but also the right thing to do. We also believe that by acting as a fiduciary we are in a better position to meet our client's needs more effectively.

At Round Table, we will continue to be champions for the best interests of our clients and will always be staunch advocates for the fiduciary model. We believe that an advisor who is held to a fiduciary standard occupies a position of special trust and confidence when working with clients because he/she is required to act with undivided loyalty to the client. Further, we believe strongly that it has clearly been proven and validated in the marketplace to be the better model for the investor because of the dramatic reduction in conflicts of interest, greater choice of investment options and no sales of proprietary investment products to clients.

ABOUT THE AUTHOR:

Anthony Rosetti is a Director, Wealth Advisor at Round Table Wealth Management, based out of our Boca Raton, Florida office. Anthony is responsible for developing and managing clients and coordinating all aspects of the Investment Management and Financial Advisory services for his relationships.

Round Table Wealth Management is a leading, independent, fee-only SEC Registered Investment Advisor (or "RIA") with offices in New York and New Jersey. RTWM operates as a multi-family office with approximately $1.3 billion in assets under management as of December 31, 2020, and serves a diverse client base throughout the U.S. as well as internationally. Founded in 1999 to provide objective investment advice, RTWM offers a wide range of advisory services and investment solutions that are tailored to the specific needs and requests of each client. Learn more at **www.roundtablewealth.com**.

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Footnotes

1. Securities Exchange Act of 1934, Sec. 3 (a) (4) (A)
2. SEC Study on Investment Advisers & Broker-Dealers, January 2011, page iv
3. SEC Study on Investment Advisers & Broker-Dealers, January 2011, page iv
4. FINRA Rule 2111, Suitability (a)
5. Investment Advisors Act of 1940, Sec. 211 (g) (1)
6. SEC Study on Investment Advisers & Broker-Dealers, January 2011, page iii
7. Investment Advisors Act of 1940 as referenced by Investopedia Website (www.investopedia.com)
8. SEC Study on Investment Advisers & Broker-Dealers, January 2011, page iii
9. The Cerulli Report, US RIA Marketplace 2020