

RIA vs Broker-Dealers

Because there are some glaring differences in the types of investment firms available to investors, the one you choose can have a significant impact on how your assets are managed. The two types are Registered Investment Advisory firms (RIA's) and Broker-Dealers. Depending on their size, RIAs are registered with the Securities and Exchange Commission (SEC) or their state securities regulator. Most broker-dealers are members of the Financial Industry Regulatory Authority (FINRA), which is regulated under the Securities and Exchange Act of 1934.

So, what are the primary differences investors should be aware of?

- Fiduciary Standard vs Suitability Standard
- Transparency vs Disclosure
- Fees vs Commissions
- Professionalism and Investment Decisions

Fiduciary Standard vs Suitability Standard

Advisers (Fiduciary): RIAs are ethically and legally responsible to act in your best interests at all times, thanks to the Investment Advisers Act of 1940, RIA's are held to a higher standard of conduct than registered representatives. This standard, called a fiduciary, mandates that an RIA must always unconditionally put the client's best interests ahead of his or her own, regardless of all other circumstances.

Brokers (Suitability): A broker, or "Registered Representative" as they are sometimes called, is required only to recommend investments that are "suitable" for their clients. The suitability standard is less stringent than the fiduciary standard in terms of the advisor's obligation to make recommendations that are in the client's best interest. This means that a broker can legally put his or her own interest above yours when recommending financial products for your specific situation.

Transparency vs Disclosure

Advisers (Transparency) must adhere to a higher standard of transparency. Because advisers share details about all aspects of their services and how they earn their fees, you can better understand how your assets are being cared for and the costs associated with that care. Every RIA is legally obligated to send their clients a copy of their Form ADV, a filing that explains the makeup of their firm, what services they offer, and what they charge. RIAs are also required to disclose any possible conflicts of interest to their clients and act in an ethical manner in all of their business dealings.

Brokers (Disclosure) typically follow the rules for legal disclosures, with prospectus booklets and lengthy legal documents printed in small-type in highly formal and hard-to-read language with the fees and other costs buried within the documentation.

Fees vs Commissions

Advisors (Fees): RIAs are paid an advisory fee directly from the client for advice and service, usually a percent of assets under their care. The fees are disclosed up front so there is no confusion as to what the cost is for their services. With this type of compensation system, RIAs are incentivized to protect and grow their client's assets because they are directly tied to their client's success.

Brokers (Commissions): Brokers are paid by commissions, loads, 12b-1 fees, finder's fees, and sales bonuses that are based on the type of securities and number of trades. No matter how the client's investments perform, a broker is not tied to that performance financially. Also, brokerage firms are usually investment product manufacturers who see their broker/employees as the prime distribution channel to sell their products.

Professionalism and Investment Decisions

Advisors (Professionalism): An RIA manages relationships from a holistic perspective across multiple financial topics. The RIA is the investment professional making recommendations, and clients have direct access to the decision maker. Investment and allocation decisions are made in a coordinated effort between advisor and client.

Brokers (Investment Decisions): Brokers are an intermediary between a buyer and seller. They arrange transactions suitable for clients and typically rely on their parent company for recommendations and portfolio allocations. As mentioned previously, many brokerage firms have their own proprietary products and incentivize their representatives to sell those products.

Though RIAs are legally bound to the regulatory standards of the various government organizations, most quality RIAs willingly accept the idea of a fiduciary responsibility to each client. That's because their own personal values and ethics in client relationships is higher than the basic legal standard. The concept of an uncompromising fiduciary responsibility is at the very core of their values. RIA's know that in order to gain your trust and build relationships, we must be transparent and offer uncompromised advice.

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