# The Distinction Between an RIA and a Broker

## INTRODUCTION

The line of distinction between a "Registered Investment Advisor" and a "Broker" has been blurred to the point where consumers are generally unaware of their differences. These differences are significant, extremely material, and should be fully understood by any person seeking professional asset management services. This document is intended to define, contrast, and clarify the legal definition and obligations of each.

## LEGAL OBLIGATION

**RIA**: An RIA is subject to a "fiduciary standard of care" which is the highest standard in the financial services industry.

What is the Legal Obligation of a Fiduciary?

> "A fiduciary duty is an obligation to act in the best interest of another party...A fiduciary obligation exists whenever the relationship with the client involves a special trust, confidence and reliance on the fiduciary to exercise his discretion or expertise in acting for the client...A person acting in a fiduciary capacity is held to a high standard of honesty and full disclosure with regard to the client and must not obtain a personal benefit at the expense of the client."

**Broker**: A broker is subject to a "suitability standard" which is less than a fiduciary standard.

What is the Legal Definition of Suitability?

> FINRA Rule 2111 requires that a firm or associated person have a reasonable basis to believe a recommended transaction or investment strategy involving a security or securities is suitable for the customer. This is based on the information obtained through reasonable diligence of the firm or associated person to ascertain the customer's investment profile.

Summary

> While a broker and an RIA will base investment recommendations on the customer's investment profile, an RIA may consider a broader range of information, such as the client's required rate of return and other factors. Perhaps the most important issue is that a fiduciary has a legal obligation to act in the client's best interests, *at all times.* A broker has no such obligation.
>
> The standard of a fiduciary is the highest standard in the industry and as such, provides clients with greater protections than are afforded through a broker.

The following page contains important details, highlighting additional differences between an RIA and a broker.

## Disclosure Requirements

**RIA**: An RIA is a fiduciary, and as such, is required to provide full and complete disclosure to clients of all material information related to their business, including all conflicts of interest, methods of compensation, and past disciplinary actions.

**Broker**: A broker is not legally required to disclose to clients all conflicts of interest, methods of compensation, or past disciplinary actions.

## Methods of Compensation

**RIA**: An RIA will charge for asset management services on a fee-only basis and will not receive commissions.

**Broker**: In general, a broker is a salesperson who receives a commission based on the transaction.

## Sales Inducements

**RIA**: An RIA is prohibited from accepting any sales inducements unless it is fully disclosed to the client. Sales inducements include the receipt of soft dollars and gifts from investment wholesalers (ex: mutual fund wholesalers).

**Broker**: A broker can accept soft dollar compensation and gifts (in certain circumstances) from investment wholesalers and is not required to disclose it to clients.

## Consumer Protection

**RIA**: As a result of the fiduciary standard, clients have a higher level of protection with an RIA.

**Broker**: Clients have a lower level of protection with a broker.

## Record Keeping Requirement

**RIA**: More stringent

**Broker**: Less stringent

## Regulated/Governed By

**RIA**

Strict fiduciary laws

Uniform Prudent Investor Act (UPIA)

State trust/fiduciary laws

Securities and Exchange Commission *or* State Regulators

**Broker**

Financial Industry Regulatory Authority (FINRA)

## Summary

Brokers have a lower legal standard than RIA's, and as such, offer less protection to consumers.