UNDERSTANDING DIFFERENT TYPES OF FINANCIAL ADVISORY RELATIONSHIPS

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The Securities and Exchange Commission (SEC) and RAND Corporation conducted a nationwide study in 2018 to understand individual investors' familiarity with the roles and responsibilities of different types of financial advisors. Their findings are eye-opening, and they point to a deep need for education about the differences in advisory relationships.

For example, The Retail Market for Investment Advice (the study's final report) notes that slightly more than one-third of survey respondents were able to accurately characterize their advisor's registration status. This may not sound like a riveting development, but it highlights a drastic misperception between clients' expectations and the reality of their advisory relationships. As the report states, the study's research suggests "that retail investors do not understand the differing roles and legal obligations required of financial service professionals."

It's worth noting that the SEC has been conducting research to serve as the foundation of potential rule changes that could alter the responsibilities in some of the advisor-client relationships under its jurisdiction. Nothing official has been announced, however, and the recent hand-off in Congress could delay the anticipated changes.

This also raises the point that there are organizations *besides* the SEC that regulate the roles and responsibilities of financial professionals, both at the federal and state levels. It's no wonder that investors suffer from a lack of clarity on this issue.

With an eye toward helping investors gain a better understanding of advisor-client relationships, we've composed brief explanations characterizing the differences among several of the most prominent types of advisors.

Registered Investment Advisers | The Investment Adviser's Act of 1940 governs the activity of registered investment advisers, or RIAs, who register with either the SEC or a state securities regulator. RIAs are required to uphold a fiduciary duty to their clients—which is typically taken to mean that RIAs must put a client's interests first when providing advice or acting on their behalf.

Arguably, the most rigorous aspect of an RIA's fiduciary duty centers on transparency. Any real or potential conflicts of interest—such as outside business interests that could influence advice—need to be disclosed and explained.

Broker-Dealers | Looking a bit further back, the Securities Exchange Act of 1934 governs brokers and dealers who operate in U.S. securities markets. "*Broker*" typically refers to someone who arranges transactions between two parties (like stock brokers) while a "*dealer*" sells from their own inventory (like bond dealers). The SEC regulates broker-dealers as well.

Broker-dealers have a responsibility to recommend investments that are suitable to their clients, based on client-specific information, and are required to have an adequate and reasonable basis for recommending investments or strategies. There is no fiduciary requirement for broker-dealers to act in their clients' best interests.

Trust Officers | Bank, trust company and federal savings association employees can apply to the Office of the Comptroller of the Currency for trust powers. These can be as broad as "full or general trust powers" or limited to a subset like escrow, estate administration, investment management, advisory or others.

Trust officers are required to serve in a fiduciary capacity, although it's governed differently from the standard applied to RIAs. See the Code of Federal Regulations, Part 9 for more information about the fiduciary activities of national banks.

Insurance Agents | The regulation of insurance in the United States has traditionally been conducted at the state level. Given the variability in laws, there's a risk of over-generalization in characterizing the client-agent relationship.

Insurance professionals are obligated to provide honest and accurate answers to their clients' questions. Those marketing themselves as specialists in a particular type of insurance are typically held to higher standards regarding the quality and accuracy of their advice. However, in some states, insurance agents have a fiduciary obligation to their employers—the insurance company—while no such standard exists between the agent and their clients.

Professionals working in an advisory role can choose to serve in a fiduciary capacity for their clients even if it's not required by the regulatory standards that govern their registration. The Certified Financial Planner designation requires acceptance of fiduciary responsibility, and there are other fiduciary standards for financial professionals that advisors can adopt in their work on clients behalves.

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