

Registered Investment Advisor (RIA) or Broker-Dealer (B-D)?

Know the Differences Before Choosing a Partner

If you are seeking to establish a separately managed account for your institutional cash investments, you must first decide whether to retain the services of a Registered Investment Advisor (RIA) like Capital Advisors Group or a broker-dealer (B-D). RIAs that are regulated by the [U.S. Securities and Exchange Commission \(SEC\)](#) have a legal obligation to act as a fiduciary for their clients and must put their clients' interests in front of their own. In dealing with institutional investors¹, B-Ds must meet a suitability standard set by the [Financial Industry Regulatory Authority \(FINRA\)](#) which is less stringent than the fiduciary standard required of RIAs.

There are three key areas to consider before choosing an RIA or B-D:

1. Where Assets are Held and How are They Registered?

Registered Investment Advisors are subject to strict rules regarding the safeguarding and custody of client assets. Capital Advisors Group never takes possession of client assets, instead, our clients maintain a segregated bank custody account to hold their assets in their own name. Assets held by a bank in a custodial account are not part of the bank's assets or balance sheet. Regardless of whether a bank fails or is bought, custody assets remain the property of the beneficial owner and are not subject to the claims of the bank's creditors.

Broker-Dealers on the other hand may hold assets on their balance sheet in "street name," meaning investments are registered in the name of the B-D and not the client. In the event of the default of the B-D, client assets may be subject to claims from their creditors. B-Ds may also commingle client assets on their own balance sheet which may add to a lack of transparency for the client. B-Ds may offer clients "brokerage custodial services," but this may be in the form of assets being held on the B-Ds balance sheet in "street name" rather than in a segregated bank custody account. While the naming convention of custody sounds the same, cash investors should be

aware of these important distinctions.

Questions to Ask a Broker-Dealer:

- What is the structure of my investment account?
- Are my assets commingled with your other client assets?
- Are my assets held in a third-party "street name," or will they be held in a segregated bank custody account in my company's name?
- Are my assets held on your balance sheet and subject to claims from your creditors?

2. What are Fees and Performance Incentives?

Registered Investment Advisors have a transparent fee structure and can either charge fees based on a percentage of assets under management (AUM), a flat fee for providing investment advice and/or services, or performance-based fees. These fees may include the cost of custody and other services, so it is important to understand what is included in the fee when comparing offerings. It is also important to note that RIAs have a fiduciary obligation to provide investment advice and/or services that are always in the best interests of the client, regardless of the level or type of fees that they charge.

Broker-Dealers typically earn a fee from a client by executing transactions on their behalf. This is often accomplished by receiving a transaction-based fee, also known as a “spread” or “commission” for buying and/or selling securities, a percentage of total sales fee, a flat fee, or a blend of these fee structures. It is important to note that, in dealing with institutional investors, B-Ds do not have a fiduciary obligation to their clients that would require them to put their clients’ interests in front of their own. Lastly, while many B-Ds tout their services as a “no fee” offering, this is simply not true. While their fees may not be transparent, they are typically making money on the transactions of investments in their clients’ accounts. Additionally, if assets are held on their balance sheet, they may also be earning additional revenue by lending clients’ securities to others in the market in a structure called “securities lending.”

Questions to Ask a Broker-Dealer:

- How much are you getting paid to manage my company’s assets?
- Are you collecting a spread or commission on assets you buy and sell?
- If you earn commissions and spreads on trades, can you account for those costs on a per-security basis?
- Will I know if my fees change?

3. How a Portfolio is Managed?

Registered Investment Advisors can help create and follow a client’s existing Investment Policy Statement (IPS) to ensure all investment advice and services are aligned with the client’s goals and objectives. RIAs have a fiduciary obligation to provide unbiased investment advice to clients on their portfolio and all purchases and sales of individual securities and other investment vehicles. When purchasing or selling securities, RIAs have a duty to seek “best execution” on their clients’ behalf, often requiring them to seek multiple bids and offers in the market.

Broker-Dealers, in providing advice to institutional investors, do not have a fiduciary obligation to their clients; therefore, while they may purchase investments that meet the suitability standard and are allowed by their clients’ IPSs, they may not be truly in the client’s best interest. In the same context, B-Ds do not have a specific duty to seek best execution and

may sell clients securities from their own inventory which might not result in “best execution.”. Additionally, B-Ds may not have access to credit research teams and other departments that are focused explicitly on cash management that may help create a more well-rounded investment experience.

Questions to Ask a Broker-Dealer:

- Do you sell from your own inventory of securities or solicit competitive bids in the open market?
- How many broker-dealers do you work with to source securities?
- Do you have a conflict of interest that incentivizes you to purchase or sell securities that allow you to take a bigger spread or commission rather than purchase or sell securities more aligned with my investment strategy?
- Do you have a dedicated credit team focused on cash investments? Do you have a dedicated portfolio manager?

The SEC, under Regulation Best Interest (“Reg BI”), imposes additional obligations that apply to broker-dealers when making recommendations to “retail customers” (i.e., natural persons) only. Reg BI does not apply to “institutional investors.”

Disclosure

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