



Complexity of Financial Services Industry Makes It Difficult for Individual Investors to Distinguish Broker-Dealers and Investment Advisers



FOR RELEASE

Thursday

January 3, 2008

The financial services industry is complex and financial service professionals are becoming less distinguishable and more inter-related, according to a new RAND Corporation [report](#) issued today.

The study found that while individual investors typically fail to distinguish the different duties and services provided by broker-dealers and investment advisers, investors are generally highly satisfied with their own financial service providers.

"Partly because of the diversity of business models and services, individual investors are not aware of the differences between broker-dealers and investment advisors," said Angela Hung, the study's lead author and an economist at RAND, a nonprofit research organization. "Nonetheless, investors are generally satisfied with their own financial service provider. This is primarily attributable to the personal attention they receive rather than from the financial returns they experience."

Research shows that trends in the financial services industry over the past 15 years have blurred the boundaries between broker-dealers, which are regulated by the Securities Exchange Act of 1934, and investment advisers, which are subject to the Investment Adviser Act of 1940.

The U.S. Securities and Exchange Commission attempted in recent years to clarify the boundaries between broker-dealers and investment advisers, but the regulation it developed was challenged and eventually overturned (*Financial Planning Association v. Securities and Exchange Commission*).

The SEC selected RAND to examine the current business practices of broker-dealers and investment advisers and explore individual investors' perceptions as to the differences between, and relationships among, the two.

"Broker-dealers and investment advisers have been subject to separate regulatory structures since the 1930s," Hung said. "But in the past few decades the lines between the two have become increasingly blurred. The SEC can use the findings of this study to better evaluate the current legal and regulatory structure."

The study includes an analysis of the business practices of thousands of investment advisers and broker-dealers based on information they report in regulatory filings. It also includes analysis of companies that offer both brokerage and advisory services or that are affiliated with companies that offer the complementary service.

To assess investor understanding, the study includes results from an extensive household survey of 654 experienced and inexperienced investors. RAND researchers also conducted six focus groups of experienced and inexperienced investors.

Researchers found that most companies serve as an investment adviser or as a broker-dealer without any affiliations with those that provide the complementary service. A number of other companies, however, were directly engaged in only one type of activity, but were affiliated with a company engaged in the other type. A minority were involved in both brokerage and advisory activities.

Smaller companies, which are much more numerous, tend to provide a more limited and focused range of either investment advisory or brokerage services, although they frequently report some sort of affiliation with companies providing the complementary service.

Hung said these affiliations further blur the boundaries among types of financial services.

"In many cases, we found it difficult to disentangle the services and business relationships of firms that were dually registered or affiliated with other firms," she said. "So it isn't surprising that the typical investor finds it hard to understand the nature of the investment advisory or brokerage businesses."

The study found that, in general, the roles of broker-dealers and investment advisers were confusing to most of the household survey respondents and focus-group participants. The survey respondents and focus-group participants indicated they have a general sense of the difference in services offered by brokers and by investment advisers, but that they are not clear about the differences in their specific legal obligations.

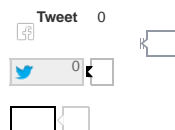
Moreover, the study found that survey respondents and focus group participants were unclear about the role of financial professionals who use generic titles, such as "financial advisor" and "financial consultant."

Hung said that after receiving information detailing some key differences between investment advisers and broker-dealers, focus-group participants reported that the compensation structures, disclosure requirements and legal duties make investment advisers appealing. However, participants reported that the account minimums, industry certification and costs make broker-dealers appealing.

The study, "[Investor and Industry Perspectives on Investment Advisers and Broker-Dealers](#)," can be found at www.rand.org and on the SEC's web site www.sec.gov.

Other authors include Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, and Farrukh Suvankulov.

The study was conducted by the [RAND Institute for Civil Justice](#), which helps make the civil justice system more efficient and equitable by supplying government leaders, private decision makers and the public with the results of objective, empirically based, analytic research.



About the RAND Corporation

The RAND Corporation is a research organization that develops solutions to public policy challenges to help make communities throughout the world safer and more secure, healthier and more prosperous.

Media Resources

RAND Office of Media Relations

(703) 414-4795
(310) 451-6913
media@rand.org

Explore

All News Releases

[By Date](#)

Related Topics

[Banking and Financial Services](#)

[Finance](#)

[Financial Decision Making](#)

[Law and Business](#)

Research Conducted By

[Institute for Civil Justice](#)

[RAND Justice, Infrastructure, and Environment](#)