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Exploring Dual Registration for Financial Advisors
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Dual Registration

In my [previous article](https://www.hillsonconsulting.com/uploads/1/3/4/3/134331594/path_to_independence_-_article_2_-_beacon_partners_collaboration.pdf)[1], I mentioned dual registration as part of the decision-making process regarding independence and quasi-independence. *Per an Inversent report, as of 2018, 83% of all advisors were dually registered* [2]. Given this very large percentage of advisors who fall into this category, it is alarming how much misunderstanding occurs related to this topic.

What is Dual Registration?

Dual registration is where an advisor holds a Registered Investment Advisor (RIA) license and also a Broker-Dealer (BD) license, typically a Series 7. This means the advisor will be acting as a fiduciary in some cases and as a transactional broker in others.

There are some nuances regarding dual registration, but the crux is how you charge for your services. If you are charging a wrap fee it is deemed as an RIA activity. If it is a transactional fee or commission it is BD transaction. Some products have to run through a BD structure. In most situations, there is an

[1] https://www.hillsonconsulting.com/uploads/1/3/4/3/134331594/path_to_independence_-_article_2_-_beacon_partners_collaboration.pdf
[2] https://www.inversent.com/education/dually-registered-advisors/

element of discretion and this is often where the situation becomes complicated, both from a compliance point of view and transparency to clients.

Typical Iterations of Dual Registration

- An independent advisor who has their BD rep registration through a separate legal entity BD
- Advisor as part of larger RIA platform, registration through separate partner BD
- Advisor with an RIA/BD hybrid which holds both registrations
- Advisor only, no BD registration

Benefits to the Advisor

There are 2 main reasons why an advisor would want dual registration:

1 – Ability to earn commission

This can be on variable annuity sales and trails, which almost always require a BD registration to charge the commission and trail. Or commission on certain products or individual trades, where otherwise an advisor would be missing out on some or all compensation.

2 – Flexibility

Flexibility on how to bill - choice of whether to charge as part of the ongoing RIA wrap fee; hourly fee; or whether to charge a one-off commission. If an advisor is recommending a considerable amount of alternative investment strategies to their clients, dual registration makes a lot of sense.

The Client

The key point here is the client's best interest. I hate to be cynical, but if an advisor cannot get paid on a certain transaction because they do not have a BD registration, are they still going to recommend it? Or convince themselves something else which pays them is indeed "better" for the client?

To quote Chris Davis' article in Advisors Magazine "Imagine – would you ever want to use a doctor that does not have access to every possible solution to help you? Of course not." [3]

Therefore, having access to more options and rightfully being compensated for your work makes perfect sense. The key point here is transparency. Many client issues arise from a lack of understanding and poor communication. If you explain to the client the rationale for billing a certain way and it is indeed in their best interests, you are providing a service to clients that others cannot.

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[3] http://www.advisorsmagazine.com/component/content/article/242-feature-article/23567-what-you-should-know-about-the-fiduciary-broker-and-dual-registered-advisor

Unfortunately, some poorly chosen BD alliances can ultimately hurt the client. *"If an advisor does not conduct their research fully and properly, you could find yourself aligned with a BD that has production quotas or pushes their own product. As soon as that happens, there is a lean toward a recommendation which may not be the best solution for the client"* - **Mike Reisel, Founder of Redwood Financial Strategies.**[4]

What does this mean to the advisor?

Unfortunately, as in most facets of life, nothing comes for free. This increased flexibility places an additional compliance burden on the advisor. The advisor must paper their file to show why they have elected to charge in a certain way, to show it is not disadvantageous to the client.

Let's take an example:

- An advisor recommends a client invest $100k into a REIT
- The advisor typically charges 1%/year AUM fee
- The REIT allows the advisor to either take 3% upfront commission (paid by the REIT, not a front-end load) or the advisor charges on the REIT investment as part of normal AUM billing
- If the advisor waives the 3% commission, the REIT gives the client a 3% discount

In this case, the advisor has flexibility in how they charge, as long as they can show the way they were compensated was fair. Perhaps in this case they take the 3% commission as they believe this is a longer term investment, which would therefore cost the client more at 1%/year. As long as the advisor does not "double dip" and can show the reasoning for the chosen billing method, the client and regulators are both satisfied.

Talking about regulators, it does also mean dealing with 2 regulatory bodies and sometimes 3: FINRA and either the SEC, state, or both. This means additional paperwork and time in an audit. This could possibly become even more cumbersome under Reg BI, which was covered in a previous article.[5]

The Hardest Part

If the firm handles dual registration internally then great. Sometimes we even see advisors move firms and have to forfeit their BD registration and lose their Series 7, God forbid! The biggest issue, which I see almost weekly is about finding a "friendly BD" and having a good relationship between BD and RIA if they are not affiliated entities. Let's look at the moving parts which need to be aligned:

- The BD and RIA are separate legal entities. They each have their own compliance and need constant communication with each other. Compliance at each firm must have confidence in the other so each firm is not essentially providing compliance for 2 firms, double the workload.
- Both must be aligned in being pro-business and not simply saying NO because something is complicated and not easily compartmentalized.

[4] Mike Reisel: mreisel@rfsplan.com
Redwood Financial Strategies: https://www.redwoodfinancialstrategies.com/
[5] https://www.hillsonconsulting.com/uploads/1/3/4/3/134331594/unintended_consequences_of_reg_bi_-_final.pdf

- There must be respect and an agreement not to poach clients or advisors – you will not believe how often I have seen this supposedly "friendly" agreement cast aside for this short-sighted reason.
- Compensation – it is very difficult for the entities to pay each other for referrals. The benefit is in having a pro-business, pro-rep alliance. It is not the short-term bottom line, so stop penny-pinching!

It is very hard to find a BD who will accommodate dual registration and honor the above points I have made. However, it is possible and is worth persevering to find the correct match. Many issues can arise if an alliance is made where the fit is not right between the BD and the RIA.

Nick Ledger, CFO and Partner at Third Seven Capital LLC[6] sees it as *"You miss 100% of the shots you don't take! There might be some initial work involved to determine whether an initiative is a fit from a compliance and a strategic perspective, but we'd rather be presented with the opportunity to run this assessment. If it ends up being in the best interest of both the client and the advisor, then it's time well spent."*. Too many regulated firms find it much easier to say NO as a default rather than getting creative to find a solution. A pro-business and flexible BD to partner with is so essential!

The previously mentioned Doctor quote offers the best metaphor for having access to dual registration. Clients will ultimately be disadvantaged by not having access to a full suite of options with regard to investments. Another disadvantage for clients occurs if the advisor does not have the flexibility to apply the correct billing approach. Transparency is key so the client understands the different billing mechanisms, and, for the advisor, the opportunity to be compensated sufficiently for your work is only fair!

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Hillson Consulting is a boutique investment consultancy founded by financial services entrepreneur Richard Hillson. The company helps independent advisors enhance and improve their offerings and drive revenue through alternative investments. We empower you to differentiate from competitors through our three pillars approach: education, access and bandwidth support.

[6] Nick Ledger: nick.ledger@thirdsevencapital.com
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