What Is a Brokerage Account? Do You Need One?

If you've been conducting research on investment options or retirement planning, then you may have come across brokerage accounts. It can be challenging to sort through all the information, but it is crucial to do so to make the best financial decision for yourself.

If you're interested in learning more about brokerage accounts, eep reading for everything you need to know, including the pros and cons, how to open one and whether or not you need one.

What is a brokerage account?

A brokerage account is a type of investment account through which you can buy, sell and trade many different types of investments. With a brokerage account, you can allocate money for retirement, college tuition, down payments and other significant life investments.

While many investment or retirement accounts do not allow you ready access to the invested assets, brokerage accounts will enable you to transfer money in and out freely, like a standard bank account.

Common types of assets in a brokerage account include:

- Stocks.
- Bonds.
- Mutual funds.
- Exchange-traded funds (ETFs).
- Other securities.

Brokerage accounts are also known as “taxable accounts” because any income gained from this investment is subject to capital gains tax, which could be 0%, 15% or 20%, depending on your filing status. Because of this, brokerage accounts are best for long-term investments rather than a fast way to play the stock market.

How do brokerage accounts work?

Generally, you do not need a large sum of money to open a brokerage account. For some, you might not even need an up-front deposit.

You will, however, need to fund the account before buying investments. Because brokerage accounts are easily accessible, you can move money into the account from your checking account, savings account or another brokerage account.

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With a brokerage account, the broker holds your account, but you own the money and the investments. The broker is simply the middleman that asks as the messenger between you and the assets you’re interested in purchasing.

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How does a brokerage account compare to other accounts?

Other common types of accounts include retirement accounts and checking accounts. To see how a brokerage account compares to these, look below.

Brokerage account

- Purpose: Investing.

- Fees: Possible maintenance fees depending on the institution.
- Taxes: Offers flexibility based on what you sell and typically must claim any capital gains as taxable income.
- Contribution limits: None.
- Withdrawal rules: No restrictions or fees.

Retirement account

- Purpose: Long-term growth and retirement savings.
- Fees: Possible maintenance fees depending on the institution.
- Taxes: Possible tax benefits depending on your chosen IRA.
- Contribution limits: Contribution limits and eligibility requirements.
- Withdrawal rules: Possible penalties for withdrawing money before retirement.

Checking account

- Purpose: Everyday spending.
- Fees: Possible maintenance fees depending on the institution.
- Taxes: Possible taxes on earned interest income based on checking account type.
- Contribution limits: None.
- Withdrawal rules: No restrictions or fees.

Individual retirement account (IRA)

- Purpose: Long-term growth and retirement savings.
- Fees: Possible maintenance fees depending on the institution.
- Taxes: Possible taxes depending on several factors, including withdrawals.

- Contribution limits: Yes, depending on year and age.
- Withdrawal rules: Yes, depending on contribution and age.

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What types of brokerage accounts exist?

There are two different types of brokerage accounts that you can open. The structure you choose will depend on how you plan to handle your securities.

Cash account

With a cash account, an investor is required to pay the entire amount for purchased securities. A cash account structure does not allow you to borrow broker funds to pay for account transactions.

Margin account

Opposite to a cash account, a margin account structure allows the investor to borrow money from the broker-dealer to purchase securities. To do this, you must have securities in your account that will serve as collateral for the loan. Remember that margin accounts, like any other loan, will require you to pay interest.

The margin account structure is riskier than a cash account because of the uncertainty of borrowing.

For example, if you purchase a security on borrowed money and your security value declines, your broker can require you to deposit cash or equivalent securities into your account to cover the loss. Your broker also has the power to sell your securities without advance notice to cover the loss.

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What are the different brokerage account ownership types?

Brokerage accounts are flexible in more than one way, as they also offer options for who will own the account.

Individual brokerage account ownership

If you choose this type, you will be the sole owner of the brokerage account, meaning it will be in your name and your name only.

Joint brokerage account ownership

If you choose this type, you can own a brokerage account with other people. Generally, those other people include spouses, children, parents or other family members.

However, joint ownership does not have to be between blood relatives; it can also simply be between people with mutual financial goals.

The three types of joint brokerage accounts include:

- Joint tenants with survivorship rights: The individuals share equal ownership rights; if one dies, the other will receive the remaining share.
- Tenants in common: If one owner dies, there is no right of survivorship and the deceased's share will be allocated to their estate.
- Community property: This ownership is reserved for married couples, and the assets are split equally. If one owner dies, the deceased's share will be allocated to their estate. This type of ownership is not available in all states.

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What are the pros and cons of a brokerage account?

When making investment decisions, it is essential to weigh the benefits and drawbacks to determine the best possible outcome. To help see both sides, look at the pros and cons below.

Pros of a brokerage account

1. Diversification: Whether you're a seasoned investor or a beginner, you can diversify your portfolio and gain experience with new ventures. In addition, because of the different areas of investments, gains in one area may offset losses in others.
2. Convenience: Online brokerage accounts make all operations easy and accessible, as they can be completed from home. However, if you prefer to deal with your broker in person, investing with a brokerage firm you can physically visit is also an option.
3. Growth potential: Brokerage accounts are a long-term investment, but they can help grow wealth over time. Stocks are generally the asset that will garner the most significant return; however, having multiple assets like you can with a brokerage account is a considerable advantage.
4. Liquidity: There are few restrictions on handling your brokerage account investments, meaning you can access, buy and sell assets quickly and easily.
5. Managed by professionals: With an online brokerage account, you may have access to a robo-dealer that will provide investment suggestions based on data. With a broker, you will have a human account advisor to advise your portfolio based on data and their expertise.

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Cons of a brokerage account

1. Market risk: When you invest in stocks, there is always a risk because it is subject to market fluctuation.
2. Fees: You will generally encounter fees with brokerage firms as part of the payment for their service. These fees may include maintenance fees, annual fees and trade execution fees.
3. Regulatory risk: Government agencies like the Securities and Exchange Commission (SEC) regulate brokerage firms, meaning those regulations and enforcements may impact the firm, its stability and, therefore, your investments.
4. Limited guarantee: Generally, brokerage firms are Securities Investor Protection Corporation (SIPC) members. This is not the same as being a member-FDIC entity, meaning FDIC insured. The SIPC does provide guaranteed asset protection but only up to a certain amount, and it does not protect against market losses.

How can you open a brokerage account?

If you’re ready to take your research to the next level, dive into this step-by-step process of opening a brokerage account.

1. Choose the brokerage account type

Remember, there are two account types: cash accounts and margin accounts. The cash account means everything you invest and trade is directly from your funds.

The margin account allows you to borrow money from the financial institution but comes with a loan’s risks.

2. Compare costs and incentives

Many brokers offer commission-free trading and incentives for choosing their firm. Make sure to compare firms you are interested in to see which one will work best for you.

In addition to the incentives, examine the broker's full pricing schedule for all assets, as many firms charge for trades that do not involve stocks.

3. Consider services and conveniences

Finding the correct prices and incentives is a large part of the research; however, there are other considerations to make.

When choosing a full-service firm, you should be considering:

- Access to research: Many brokerage firms use their own stock ratings in addition to the S&P 500 and Dow Jones indices. Make sure their access matches what you are looking for.
- Foreign trading: If you are interested in diversifying your portfolio with foreign trading, you must make sure you partner with a firm that offers the option to convert your account money into foreign currencies you can trade on international stock exchanges.
- Fractional shares: If you are looking for affordable options to start investing, you will need to make sure the brokerage firm offers fractional shares, which allow you to purchase a fraction of a stock share rather than the entire share.
- Trading platforms: The platform you trade is a personal preference, but you should ensure that the firm you choose operates on a platform that you deem user-friendly. With so many options, from trading software to mobile apps, it's all about what is most accessible to you.
- Convenience: How can the brokerage firm make your

experience more convenient? Consider factors like locations, online options, robo-advisors, human investment advisors, account connecting from checking to brokerage and money transfers.

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4. Choose the right firm for you

After you've done your research and considered all the options and factors, it's time to decide based on what is the right fit for you.

5. Complete the account application

Once you've determined the right fit, you'll need to complete an account application.

The application will require you to provide information like:

- Social Security number.
- Driver's license.
- Net worth.
- Employment status.
- Investable assets.
- Investment objectives and goals.

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6. Fund your account

You will need to add money to your account to begin investing.

Depending on the rules of the brokerage firm, you will be able to transfer money via the following:

- ETF.
- Wire transfer.
- Checks.

- Asset transfer.
- Stock certificates.

7. Research and select investments

Now that you've got everything settled, it's time to start researching the investments you'd like to make. Learn the basics, build responsibly and start building your portfolio.

Do you need a brokerage account?

Whether or not you need a brokerage account is ultimately up to you. They are an excellent option for long-term investment strategies that will grow over time.

Like most investments, certain risks come with brokerage accounts, but as long as you invest responsibly, they can be a great asset.

Weigh the pros and cons, consider your financial goals and determine if a brokerage account is a right move for you.

For more information on investment advice, retirement planning, financial advisors and more, visit Entrepreneur.com for the need-to-know information.

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