The Market for Financial Adviser Misconduct

Mark Egan, Gregor Matvos, and Amit Seru*

March, 2016

Abstract

We construct a novel database containing the universe of financial advisers in the United States from 2005 to 2015, representing approximately 10% of employment of the finance and insurance sector. Roughly 7% of advisers have misconduct records. At some of the largest financial advisory firms in the United States, more than 15% of advisers have misconduct records. Prior offenders are five times as likely to engage in new misconduct as the average financial adviser. Firms discipline misconduct: approximately half of financial advisers lose their job after misconduct. The labor market partially undoes firm-level discipline: of these advisers, 44% are reemployed in the financial services industry within a year. Reemployment is not costless. Following misconduct, advisers face longer unemployment spells, and move to less reputable firms, with a 10% reduction in compensation. Additionally, firms that hire these advisers also have higher rates of prior misconduct themselves. We find similar results for advisers of dissolved firms, in which all advisers are forced to find new employment independent of past misconduct or performance. Firms that persistently engage in misconduct coexist with firms that have clean records. We show that differences in consumer sophistication may be partially responsible for this phenomenon: misconduct is concentrated in firms with retail customers and in counties with low education, elderly populations, and high incomes. Our findings suggest that some firms "specialize" in misconduct and cater to unsophisticated consumers, while others use their clean reputation to attract sophisticated consumers.

JEL: G24, G28, D14, D18

Keywords: Financial Advisers, Brokers, Consumer Finance, Financial Misconduct and Fraud, FINRA

*We thank Sumit Agarwal, Jonathan Berk, Steve Dimmock, Will Gerken, Erik Hurst, Anil Kashyap, Lasse Pedersen, Amir Sufi, Vikrant Vig, Rob Vishny, Luigi Zingales, and the seminar participants at the University of Virginia, Stanford University, the University of Minnesota, the University of Chicago, and the Massachusetts Institute of Technology.

1 Introduction

American households rely on financial advisers for financial planning and transaction services. Over 650,000 registered financial advisers[1] in the United States help manage over $30 trillion of investible assets, and represent approximately 10% of total employment of the finance and insurance sector (NAICS 52). As of 2010, 56% of all American households sought advice from a financial professional (Survey of Consumer Finances, 2010). Despite the prevalence and importance of financial advisers, they are often perceived as dishonest and consistently rank among the least trustworthy professionals (e.g., Edelman Trust Barometer 2015, Wall Street Journal "Brokers are Trusted Less than Uber Drivers, Survey Finds").[2]

The view is best summarized by Luigi Zingales in his American Finance Association presidential address: "I fear that in the financial sector fraud has become a feature and not a bug" (Zingales, 2015). This perception has been shaped by highly publicized scandals that have rocked the industry over the past decade. While it is clear that egregious fraud does occur in the financial industry, the extent of misconduct in the industry as a whole has not been systematically documented. Moreover, given that every industry may have some bad apples, it is important to know how well financial industry deals with misconduct. In this paper we attempt to provide the first large-scale study that documents the economy-wide extent of misconduct among financial advisers and financial advisory firms. We examine the labor market consequences of misconduct for financial advisers, and study adviser allocation across firms following misconduct. Last, we provide some evidence that firms "specialize" in misconduct and cater to unsophisticated consumers, while others use their reputation to attract sophisticated consumers, allowing misconduct to persist in equilibrium.

More broadly, studying financial advisers provides a lens into markets in which sellers are experts relative to their customers. For example, it is difficult for consumers to ascertain the value of services provided by such professionals as doctors, attorneys, accountants, car mechanics, and plumbers. In these markets, trust and reputation are supposed to prevent the supply of poor services. Disclosure of financial advisers' misconduct is public, providing a "market mechanism" that should prevent and punish misconduct. One would imagine that in markets with less disclosure, misconduct may be even more difficult to eradicate through competition alone.

To study misconduct by financial advisers, we construct a novel panel database of all financial advisers (about 1.2 million) registered in the United States from 2005 to 2015, representing approximately 10% of total employment of the finance and insurance sector. The data set contains the employment history of each adviser. We collect all customer disputes, disciplinary events, and financial matters from advisers' disclosure statements during that period. The disciplinary events include civil, criminal, and regulatory events, and disclosed investigations.

We find that financial adviser misconduct is broader than a few heavily publicized scandals. One in

[1] We will use the term "financial adviser" throughout the paper to refer to registered representatives registered with FINRA. This includes all brokers and the set of investment advisers on BrokerCheck who are also registered as brokers.

[2] Prior, Anna. 2015. "Brokers are Trusted Less than Uber Drivers, Survey Finds." *Wall Street Journal.* http://www.wsj.com/articles/brokers-are-trusted-less-than-uber-drivers-survey-finds-1438081201 [accessed on 2/26/2015]

thirteen financial advisers have a misconduct-related disclosure on their record.[3] Adviser misconduct results in substantial costs; the median settlement paid to consumers is $40,000, and the 75^{th} percentile exceeds $120,000. These settlements have cost the financial industry almost half a billion dollars per year.[4] Misconduct is too concentrated among advisers to be driven by random mistakes. Approximately one-third of advisers with misconduct records are repeat offenders. Past offenders are five times more likely to engage in misconduct than the average adviser, even compared with other advisers in the same firm at the same point in time. The large presence of repeat offenders suggests that consumers could avoid a substantial amount of misconduct by avoiding advisers with misconduct records. Furthermore, this result implies that neither market forces nor regulators fully prevent such advisers from providing services in the future.

We find large differences in misconduct across financial advisory firms. Some firms employ substantially more advisers with records of misconduct than others. More than one in seven financial advisers at Oppenheimer & Co., Wells Fargo Advisors Financial Network, and First Allied Securities have engaged in misconduct in their past. At Goldman Sachs & Co. and Morgan Stanley & Co. LLC, the ratio is less than one in one hundred. We find that advisers working for firms whose executives and officers have records of misconduct are more than twice as likely to engage in misconduct. Differences across firms are persistent, and survive after conditioning on a firm's business model, structure, and regulatory supervision. Therefore, firms and advisers with clean records coexist with firms and advisers that persistently engage in misconduct.

After documenting basic differences in the prevalence of misconduct across financial advisers and financial advisory firms, we explore the labor market consequences of financial adviser misconduct. What punishment should we expect for misconduct? One benchmark is extreme punishment of misconduct at the firm and industry levels. Firms, wanting to protect their reputation for honest dealing, would fire advisers who engage in misconduct. Other firms would have the same reputation concerns and would not hire such advisers. Then advisers would be purged from the industry immediately following misconduct, and only advisers with a clean record would survive in equilibrium. The alternative benchmark is extreme tolerance of misconduct. Firms would not fire advisers who engage in misconduct, and employees with misconduct would not be penalized when looking for a new job. One could call this the "Zingales" benchmark, in which misconduct is a "feature of the industry, not a bug." Of course, we expect reality to fall somewhere between these benchmarks. We use the panel structure of our data to investigate how firms punish misconduct, and how advisers' misconduct records affect their employment dynamics. We then show that differences between firms play an important role in how the market for misconduct operates.

The substantial presence of repeat offenders in the pool of financial advisers implies that misconduct does not automatically result in removal of an adviser from the industry. Therefore, it is perhaps surprising that firms are quite strict in disciplining employees' misconduct. Almost half of financial advisers who engage in

[3] Our estimates of the share of financial advisers with any disclosures (misconduct and other) closely match those from FINRA.

[4] For example, the industry paid out $589mm in misconduct related settlements in 2011 and $385mm in 2012. We calculate the total cost to the industry as the sum of all settlements granted per year in our data set. Our data set contains settlements paid out over the years 2005-2015. We observe settlement/damages details for 45.80% of the misconduct related disclosures in our data set.

misconduct in a given year do not keep their job into the subsequent year. We confirm our results do not arise because of differences between firms, regulation, customer base, or labor market conditions by comparing employees from the same firm, in the same county, and at the same time. Firms do not discipline randomly, but seem to deliberately assess the extent of misconduct before making a termination decision. We find that larger monetary damages from misconduct result in a higher termination probability.

If individual firms are strict in disciplining bad employees, why are there so many repeat offenders in the population of financial advisers? To prevent repeat offenses, advisers have to be fired following misconduct and not be reemployed in the industry. Instead, we find that 44% of advisers who lost their job after misconduct find employment in the industry within a year. The hiring of employees with misconduct records undoes some of the discipline practiced by firms. However, reemployment does not imply that misconduct discipline is completely absent at the industry level. Even accounting for reemployment, advisers experience elevated probabilities of industry exit following misconduct. They experience longer unemployment spells. Conditional on finding new employment, they move to firms with a 10% reduction in compensation, and are less desirable, as measured on a social networking website for professionals. This is the case if we compare advisers with misconduct to other employees from the same firm, at the same location, at the same point in time.

Why are some firms willing to hire advisers who were fired following misconduct? If firms had identical tolerance toward misconduct, such rehiring would not take place. We find that advisers with misconduct switch to firms that employ more advisers with past misconduct records when compared with other advisers who are looking for jobs. These results suggest that there is matching between advisers and firms on the dimension of misconduct. We find further evidence of such matching when examining the composition of new hires across firms. The firms that hire more advisers with misconduct records are also less likely to fire advisers for new misconduct. This should make these firms especially attractive to advisers who might engage in further misconduct in the future. Thus the matching between firms and advisers on misconduct partially undermines the disciplining mechanism in the industry, lessening the punishment for misconduct.

The disciplinary records of financial advisers are public record. Therefore, one might ask why competition among advisers and reputation does not drive out bad advisers and firms. One potential reason is that some customers may not be very sophisticated.[5] Such customers do not know either that such disclosures even exist, or how to interpret them. If there are differences in consumer sophistication, then the market can be segmented. Some firms "specialize" in misconduct and attract unsophisticated customers, and others cater to more sophisticated customers, and specialize in honesty, in the spirit of Stahl (1989) and Carlin (2009).

To shed more light on this mechanism, we collect additional data on financial advisory firms' customer base from the SEC Form ADV. Retail investors, who are not high net worth individuals, are generally considered less sophisticated.[6] We find that misconduct is more common among firms that advise retail

[5]For other examples of work on consumer sophistication and household financial decisions see, for example, Gabaix and Laibson 2006; Hastings and Tejeda-Ashton 2008; Carlin and Manso 2011; Lusardi and Mitchell, 2011;Duarte and Hastings 2012.

[6]This definition is also used for regulatory purposes. The Investment Company Act of 1940 considers high net worth

investors.[7] The geographic distribution of advisory firms is also consistent with market segmentation along the lines of investor sophistication. We document substantial geographic differences in financial misconduct. In many counties in Florida and California, roughly one in five financial advisers have engaged in misconduct in the past. Misconduct is more common in wealthy, elderly, and less educated counties (Gurun et al 2015). The latter two categories have generally been associated with low levels of financial sophistication. These results, while not conclusive, suggest that misconduct is targeted at customers who are potentially less financially sophisticated.

We conduct several tests to ensure our results are robust. When studying recidivism and labor market outcomes of advisers following misconduct, we compare financial advisers within a firm, in the same county, in the same year. Therefore, the conclusions from this analysis are not the result of firm differences. However, in our baseline analysis we need to construct a control group for advisers who engaged in misconduct and switched jobs. The control group consists of advisers who were employed at the same firm, in the same location, at the same time who also switched jobs. One might be concerned that the control group does not accurately represent the average adviser at the firm. To address this concern, we examine outcomes of advisers from dissolved firms. In such firms, all advisers, independent of past misconduct, are forced to find new employment. The results mirror those from our baseline specification qualitatively as well as quantitatively. We find these patterns for investment advisers, who are subject to fiduciary duty, as well as non-investment advisers. Finally, we also examine alternative classifications/measures of misconduct as well as specifications and find similar inferences.

The economics literature on fraud and misconduct dates back to the seminal work of Becker (1968) on crime and punishment. Our paper is related perhaps most closely that of Dimmock et al. (2015), who study the transmission of brokerage fraud through peer (career) networks. Using a subsample of brokers in the United States, Dimmock et al. find evidence suggesting that fraud is contagious across firms. This is consistent with our finding that the incidence of fraud varies systematically across firms.[8] A recent literature has documented similar evidence in the mortgage industry (Piskorski, Seru, and Witkin 2013; Griffin and Maturana 2014). The paper also relates to the long literature on corporate fraud, including: Povel et al. (2007), Dyck et al. (2010; 2014), Wang et al. (2010), Khanna et al. (2015), and Parsons et al. (2015).

Our paper is also related to a broad literature studying how labor markets punish corporate misconduct (Fama, 1980; Fama and Jensen, 1983). For example, directors loose board seats if their firms restate their earnings (Srinivasan, 2005), are engaged in class action lawsuits (Helland, 2006), or financial fraud (Fich and Shivdasani 2007). It is also connected to work that assesses if CEOs are also more likely to lose their jobs if their firms engage in financial misconduct (e.g., Agrawal, Jaffe, and Karpoff 1999). Karpoff et al. (2008) find that CEOs who lose their jobs following regulatory enforcement actions also do worse in the labor market

individuals to be more sophisticated than smaller retail investors, allowing them substantially more latitude in their investments.

[7] The type of compensation firm charge to clients is correlated with misconduct. Advisory firms that charge based either on assets under management or commissions tend to have higher rates of misconduct than firms that charge based on performance.

[8] There is also a related literature which has argued that financial advisers steer clients towards worse financial products without engaging in misconduct (e.g., Bergstresser, Chalmers, and Tufano, 2009; Mullainathan, Noeth, and Schoar, 2012; Christoffersen, Evans and Musto 2013; Chalmers and Reuter, 2015; Egan 2015).

in the future.

Our paper is also broadly related to work that has evaluated the role and mechanisms through which financial intermediaries shape decisions of households. For example, Anagol, Cole, and Sarkar (2013) in the insurance industry, Gurun, Matvos and Seru (2015) in the mortgage industry, Hastings, Hortacsu and Syverson (2015) in the fund industry, and Barwick, Pathak and Wong (2015) in the real estate industry.

Our paper is also related to work that studies the role of financial professionals' in shaping household asset allocation decisions when these depend on trust and consumer sophistication (see, Gennaioli, Shleifer and Vishny 2015, Guiso, Sapienza, and Zingales 2008, and Garleanu and Pedersen 2016). Our work adds to this literature by empirically illustrating the potential role of consumer sophistication in determining the types of financial firms households choose when deciding to allocate their wealth.

Our findings suggest that a natural policy response to lowering misconduct is an increase in market transparency and in policies targeting unsophisticated consumers. In doing so, our paper connects to the literature that has evaluated various policy responses in regulating consumer financial products (Campbell, 2006; Campbell et al. 2011; Agarwal et al. 2009 and Agarwal et al. 2014).

2 Data and Descriptive Statistics

We construct a novel data set containing all financial advisers in the United States from 2005 to 2015. We collect the data from FINRA's BrokerCheck database. For each adviser, the data set includes the adviser's employment history, qualifications, and disclosure information. In total, the data set contains 1.2 million financial advisers and includes roughly 8 million adviser year observations over the period. We also collect information on the universe of financial advisory firms from the BrokerCheck database.

We supplement our FINRA data set with additional firm-level data. For a small subset of the firms we observe firm assets, revenues, and compensation structure data from a private survey. We acquire data on the popularity of a firm using CVs in the database of a leading social networking website for professionals. We hand-match the names of the firms to FINRA data. We also utilize county-level data from the 2010 Census and the 2010-2013 American Community Survey to obtain country-level employment and demographic information. Last, we collect data on firms' customer base and fee structure from Form ADV, which investment advisory firms file with the SEC. We match this data to BrokerCheck data exactly, using the unique numerical identifier, CRD#.

2.1 Financial Adviser-Level Summary Statistics

Our data set contains all financial services employees registered with the Financial Industry Regulatory Authority (FINRA). This includes all brokers and the vast majority of investment advisers. Throughout the paper we refer to a financial adviser as any individual who is registered with FINRA but are careful to make distinctions about additional registrations or qualifications a financial adviser may hold such as being

a registered investment adviser or a general securities principal. Brokers (or stockbrokers) are registered with FINRA and the SEC and are defined in the Securities and Exchange Act 1934 as "any person engaged in the business of effecting transactions in securities for the account of other." An investment adviser provides financial advice rather than transaction services. Although both are often considered "financial advisers," brokers and investment advisers differ in terms of their registration, duties, and legal requirements. Throughout the paper, we will use the FINRA terminology and refer to both investment advisers and brokers as "financial advisers." We present results for the two groups separately in Section 6.

The data set contains a monthly panel of all registered advisers from 2005 to 2015. This panel includes 644,277 currently registered advisers and 638,528 previously registered advisers who have since left the industry. For each of the 1.2 million advisers in the data set we observe the following information:

- The adviser's registrations, licenses, and industry exams he or she has passed.
- The adviser's employment history in the financial services industry. For many advisers we observe employment history dating back substantially further than the past ten years.
- Any disclosures filed, including information about customer disputes, whether these are successful or not, disciplinary events, and other financial matters (i.e., personal bankruptcy).

Table 1a displays the average characteristics of financial advisers. Approximately half of active advisers are registered as both brokers and investment advisers. The advisers in our data set account for roughly 0.50% of all employed individuals in the United States and approximately 10% of employment of the Finance and Insurance sector (NAICS 52). Central to our purposes, over 12% of active financial advisers' records contain a disclosure.[9] A disclosure indicates any sort of dispute, disciplinary action, or other financial matters concerning the adviser.

Not all disclosures are indicative of fraud or wrongdoing. We describe the broad classification of disclosure categories in detail in Appendix A-1. In Section 3.1 we classify the categories of disclosure, which are indicative of fraud or wrongdoing as misconduct. We classify other categories that are less directly indicative of wrongdoing into a separate category called "Other Disclosure." We find a substantial amount of misconduct in the industry: 7.28% of financial advisers have misconduct disclosure on their record.

Table 1a reports the share of advisers who have passed any of the six most popular qualification exams taken by investment professionals. In the Appendix A-2 we provide details of each qualification exam. Most states require that a registered financial representative, at a minimum, pass the Series 63 exam, which covers state security regulations. The Series 7 exam is a general securities exam that is required by any individual who wishes to sell and trade any type of general securities products. The Series 65 and 66 examinations qualify individuals to operate as investment advisers. Although not required by all states, most investment advisers hold either a 65 or 66 examination. A Series 6 exam qualifies an investment adviser to sell open-end

[9] Our share of advisers with disclosures over the 2005 to 2015 period, 12.7%, closely matches those by FINRA of 12.6%, estimated for currently registered advisers in March of 2016.

mutual funds and variable annuities. Finally, the Series 24 exam qualifies an individual to operate in an officer or supervisory capacity at general securities firms.

Financial advisers are pervasive across the United States. As Table 1a shows, these advisers are spread across regions in the United States. While about one-third operate in only one state, more than 10% are registered to operate in all fifty states. Figure 1 illustrates this pattern in more detail by displaying the distribution of advisers across United States counties as of 2015. Tables 1b and 1c display the counties with the most financial advisers in terms of the number of financial advisers and the number of financial advisers per capita. Not surprisingly, given the nature and size of the regions, the New York, Los Angeles, and the Chicago metropolitan areas rank the highest in terms of the number of financial advisers.

2.2 Firm-Level Summary Statistics

The FINRA BrokerCheck database also contains details on the firms the advisers represent. Firms are defined by the corresponding CRD identification number. Firms with distinct CRD# can share a same parent company. For instance, Wells Fargo, operates several financial services businesses under separate CRD#s. In particular, Wells Fargo has several operations such as Wells Fargo Financial Network (CRD# 11025), Wells Fargo Advisers (CRD# 19616), and Wells Fargo Securities (CRD# 126292). The different CRD numbers reflect different operations and business lines. For example, Wells Fargo Financial Network is an arm of Wells Fargo comprised of independent advisers that are affiliated but not technically employed by Wells Fargo (https://www.wfafinet.com/). Wells Fargo Advisers reflects Wells Fargo's in-house network of advisers. Similarly, Morgan Stanley has several operations such as Morgan Stanley & Co. (CRD# 8209), and Morgan Stanley (CRD# 149777).[10] The active advisers in our data work for one of over 4,178 different firms. Figure 2a displays the distribution of these firms. The average firm employs just over 155 advisers. Firms range from one employee to over 30,000 advisers. Table 2a displays the ten largest firms in terms of the number of advisers. For each firm we observe the firm's business operations, including its size, number of businesses/operations, and referral arrangements. We also observe registration information such as the number of states the firm is registered in and the number of regulatory memberships. Finally, we observe the type of incorporation. We will use several of these firm characteristics in our analysis.

Table 2b displays the average firm characteristics. The bulk of the firms in the data are limited liability companies and corporations. The average firm belongs to 1.57 self-regulatory organizations such as FINRA or NASDAQ and is registered to operate in 23.51 states. FINRA also reports details on each firm's business operations. Roughly one in four firms are registered as an Investment Advisory firm. Recall that just under half of financial advisers are also registered as investment advisers. Roughly half of financial advisory firms are affiliated with a financial or investment institution. For example, Wells Fargo Advisers is affiliated with Wells Fargo Bank. Forty-five of the firms in our sample have referral arrangements with other brokers. In

[10] We decided not to merge firms with different CRD#s for several reasons. One, any merging would be arbitrary and would reflect our choice rather than the actual firm choices in regulatory filing. Second, frequently the different CRD numbers reflect different operations and business lines, and we are interested in assessing how various business lines correlate with misconduct.

such arrangements, the firm provides investment advice to a customer but the firm does not actually handle the transaction side. Last, the average firm operates in roughly six distinct types of business operations. Such operations could include trading various types of securities (equities, corporate bonds, municipal bonds), underwriting corporate securities, retailing mutual funds, or soliciting time deposits.

3 Misconduct

3.1 Classifying Misconduct

FINRA requires that "all individuals registered to sell securities or provide investment advice are required to disclose customer complaints and arbitrations, regulatory actions, employment terminations, bankruptcy filings, and criminal or judicial proceedings." We observe the full set of such disclosures for each financial adviser across the time period of our data.

Disclosures are categorized into twenty-three categories ranging from criminal offenses to customer disputes. Table 3 displays the share of financial advisers that have disclosures in each category. Each type of disclosure is described in Appendix A-1. The nature of disclosure varies substantially and is not always indicative of wrongdoing. For example, a disclosure in the category "Financial-Final" could pertain to the financial adviser's personal bankruptcy. Although a consumer may have reason to be leery of a financial adviser that frequently declares bankruptcy, it is not necessarily indicative of misconduct. Similarly, there may have been a consumer dispute that was resolved in favor of the financial adviser, categorized as "Customer Dispute - Denied." We also classify disclosures where the fault of the adviser is still to be determined as not indicative of misconduct, designated as "Customer Dispute - Pending." In particular, we restrict our classification of disclosures indicating misconduct to include only six of the twenty-three categories: Customer Dispute-Settled, Regulatory-Final, Employment Separation After Allegations, Customer Dispute - Award/Judgment, Civil-Final. We classify the other seventeen categories as "Other Disclosures."

We want to emphasize two points regarding our classification. First, even though we classify "Other Disclosures" separately from misconduct, these categories could also be indicative of misconduct. For example, statistically, an adviser engaged in a pending consumer dispute is more likely to have engaged in misconduct than an adviser who has not been involved in any dispute. However, because the basic description in these categories is less clearly indicative of misconduct, we are conservative and separate these disclosures. Second, we revisit the classification in Section 6 by studying the employment consequences for advisers across disclosure categories. For instance, we study whether customer disputes resolved in favor of the adviser lead to different employment outcomes than categories of disclosures that we classify as misconduct.

We measure the amount of misconduct in the economy in two ways. The first approach is to measure the amount of new misconduct, that is, how many financial advisers engage in misconduct during a given period of time. This flow measure captures the unconditional probability that an investor will encounter misconduct in their dealings with a financial adviser in a given period. Column (1) of Table 3 shows that the probability

that an adviser engages in misconduct during a year is 0.60%. Approximately half of misconduct disclosures arise from consumer disputes that were resolved in favor of the consumer. The third largest category, which captures approximately one in six disclosures, relates to actions taken by a regulator.

The second approach to measuring misconduct captures the prevalence of advisers in the population who engaged in misconduct in the past. This measure broadly captures the unconditional probability that an investor will encounter a dishonest adviser. Column (2) of Table 3 indicates that 7.28% of financial advisers have a disclosure that is indicative of misconduct during their career. Because many financial advisers have multiple disclosures pertaining to misconduct, the subcategories of disclosure that we classify as misconduct in Table 3 add up to more than 7.28%. Note that if advisers were expelled from the industry immediately upon discovering misconduct, the amount of dishonest financial advisers would have to be smaller than the amount of new misconduct. Instead, these simple statistics suggest that advisers who engage in misconduct might persist in the industry.

One in thirteen advisers have been disciplined for misconduct, suggesting that misconduct is relatively commonplace. To better understand the underlying reasons for customer and regulatory disputes, which represent the bulk of the disclosures, we analyze the descriptions of 186,381 disclosures from these categories across our sample period. Table 4a displays the eleven most common allegations cited. One in four disputes list "unsuitable" investments as an underlying cause of the dispute. This is not surprising. By law, brokers are required to only sell "suitable" investments to their clients. Misrepresentation or the omission of key facts together account for a third of disputes. Approximately 7% of allegations fall under the category of fraudulent behavior, which carries more severe penalties. The typical penalties associated with misconduct include fines, probation, and restitution. If convicted of fraud, a financial adviser could face a prison sentence in addition to fines and probation. These allegations suggest that the misconduct we measure is directly related to financial advisers' wrongdoing and fraud.

We report the most common product categories involved in misconduct in Table 4b.[11] The most popular investment products held by households[12]-insurance, annuities, stocks, and mutual funds-are the products most commonly engaged in disputes. Interestingly, the vast majority of annuity disputes are related to variable rather than fixed rate annuities. Variable annuities have often been criticized in the public for having high fees and hidden charges.[13]

We examine the severity of misconduct by collecting the damages advisers pay to clients following misconduct. Figure 4 and Table 4c summarize the distribution of damages. The median settlement for misconduct is $40,000, and a quarter of damages exceed $120,000. Therefore, misconduct is costly for the advisory firm, and suggests substantial damages to the household. To put that number in perspective, the median household net worth in the United States in 2011 was $68,828. These figures suggest that the costs of adviser misconduct are substantial, with the median settlement equal to over half of the median household net worth.

[11] We observe product information for approximately one-third of the sample.

[12] See Campbell et al. (2010).

[13] For example, http://www.forbes.com/sites/feeonlyplanner/2012/07/02/9-reasons-you-need-to-avoid-variable-annuities/ [accessed 11/17/2015]

Finally, we examine the amount of misconduct over time. Figure 3 shows that misconduct is not just a feature of the recent financial crisis. The incidence of misconduct is spread uniformly across the years in our sample. There is an increase in misconduct being disclosed in the aftermath of the recent financial crisis, but the incidence remains non-trivial across years.

3.2 Repeat Offenders

We explore whether we can predict which advisers engage in misconduct. We are especially interested in repeat offenders, advisers who engage in misconduct more than once. Figure 5a displays the share of repeat offenders. Almost 7.56% of currently registered advisers engaged in misconduct at least once during their career. Of those, 38% are repeat offenders, having two or more disclosures of misconduct. This simple summary statistic strongly suggests that misconduct does not arise due to bad luck or random complaints by dissatisfied customers. If misconduct were random and/or the result of bad luck, we would expect the share of repeat offenders to be 6.55%,[14] which is less than a fifth of the share in the data.

At this stage, it is informative to contrast these statistics with those of physicians, who offer an interesting benchmark. Appendix Table A2 displays the frequency of misconduct among financial advisers, doctors, and public employees.[15] The incidence of medical malpractice is similar to that of financial adviser misconduct. Medical malpractice, however, is substantially less concentrated among physicians: more than half of physicians in the United States have had at least one instance of medical malpractice.[16] This suggests that medical malpractice is quite random; sooner or later, most doctors are entangled one way or another. Even though the base rate of misconduct among financial advisers is similar to the rate of medical malpractice, misconduct is much more concentrated, suggesting that some advisers are more prone to misconduct than others.

The high incidence of repeat offenders suggests that past misconduct should predict future misconduct. Figure 5b investigates this claim by plotting the observed probability that an adviser is disciplined for misconduct at time t conditional on whether he or she was disciplined for misconduct at time 0. The figure illustrates that past offenders have an elevated probability of misconduct throughout their career. The probability of a repeat offense in the next year is 11%, roughly 4% five years later, and 1.50% nine years later. To put these numbers in perspective, the unconditional probability of misconduct at these horizons is roughly 0.60%. The longevity of the effect suggests that these are indeed separate offenses and not one isolated offense in an adviser's career, which unfolds over time.

We now document which adviser characteristics, including past misconduct, predict new misconduct. Consider the probability that adviser i, at firm j, in county l is disciplined for misconduct at time t. We

[14] Assuming that an adviser works for 11.25 years after receiving his or her first misconduct.

[15] See Glaeser and Saks (2006) for a detailed study on federal corruption in the United States.

[16] Krupa C. Medical liability: By late career, 61% of doctors have been sued. American Medical News. August 16, 2010. http://www.amednews.com/article/20100816/profession/308169946/2/#cx. Accessed February 3, 2016.

estimate the following linear probability model:

$$Misconduct_{ijlt} = \beta_0 + \beta_1 PriorMisconduct_{ijlt} + \beta X_{ijlt} + \mu_{jlt} + \varepsilon_{ijlt}$$

The dependent variable $Misconduct_{ijlt}$ is a dummy variable indicating that the adviser was disciplined for misconduct at time t. $PriorMisconduct_{ijlt}$ is the main independent variable of interest. It is a dummy variable indicating if the adviser was ever disciplined for misconduct prior to time t.

To ensure that the correlation between past and future misconduct is robust, we control for firm/year/county fixed effects μ_{jlt}. Doing so accounts for differences in firms' tolerance for misconduct as well as different business models firms may follow. Second, any aggregate shocks to misconduct, such as the financial crisis, are also absorbed by this fixed effect. Third, the fixed effects control for variation in regulatory conditions (subsuming any state- or county-level regulatory variation). These fixed effects also control for differences in demographics and labor market conditions in a given county at a point in time. Finally, we control for the adviser's characteristics in X_{ijlt}. We include several aspects of a financial adviser's registration: whether or not he or she is registered as an investment adviser and the number of states he or she is registered in. We also control for qualifications (Series 7, Series 63, etc.) and experience in the industry. Many of the requirements are at the state level and give financial advisers the flexibility to manage different types of accounts and assets. These proxy for the type of advising the adviser engages in.

Table 5 displays the estimates. The main coefficient of interest measures how likely an adviser with a record of past misconduct is to engage in new misconduct relative to other advisers in his or her firm, in the same county, and at the same point in time. The coefficient of 2.40 percentage points (pp) suggests that the propensity for repeat misconduct is large. Financial advisers with prior misconduct are five times as likely to engage in misconduct as the average financial adviser.

The coefficient on $PriorMisconduct_{ijlt}$ reflects a weighted average of the marginal effects reported in Figure 5b. The figure suggests that an adviser who was disciplined in the previous year is roughly 11pp more likely to engage in misconduct, but an adviser who was disciplined nine years earlier is 1.5pp more likely to do so. The coefficient on $PriorMisconduct_{ijlt}$, on the other hand, measures how likely an adviser with previous misconduct is to be disciplined in year t relative to an adviser who has not been previously disciplined, averaging across all prior misconducts. The overall incidence of repeated misconduct for an individual who has been previously disciplined is therefore greater than 2.40pp.

One interesting result in Table 5 is the relationship between the adviser qualifications and the probability of misconduct. Financial advisers who hold a Series 66 or 65 exam are more likely investment advisers who work with retail clients (i.e., individuals and households) rather than institutional clients (i.e., investment banks, mutual funds, etc.). The estimated coefficient of 0.314pp indicates that financial advisers that hold a Series 66 or 65 exam are 50% more likely to be disciplined for misconduct than the average financial adviser.

3.3 Misconduct Across Firms

Do firms differ in the amount of misconduct they generate? If firms are similar on the misconduct dimension, then an adviser fired by one firm for misconduct is unlikely a good match for other firms. If firms differ, however, then there is scope for reallocation of advisers. We first describe firms' adviser composition by measuring the percentage of employees who have ever been disciplined for misconduct. Figures 6a and 6b display the distribution of misconduct among firms with at least 100 and 1,000 advisers. In the average firm, 7.99% of its financial advisers have been disciplined for misconduct in the past. The distribution is skewed strongly to the right. The median share of advisers disciplined for misconduct is 4.67%, and among firms in the top quartile, more than one in ten advisers have been disciplined for financial misconduct. This simple cut of the data shows that firms with clean records coexist with firms that engage in a substantial amount of misconduct.

Differences in the number of dishonest financial advisers firms employ could arise because of differentiated business models. For example, some financial advisory firms could specialize in taking advantage of uninformed customers, while others use their clean image to attract more sophisticated customers. Another reason for heterogeneity could be differences in owners' risk tolerance of regulatory scrutiny. In this section we describe the extent of advisory firm heterogeneity, leaving the discussion on why such heterogeneity might arise for Section 5.

Table 6a and 6b display firms with at least 1,000 advisers with the highest and lowest incidence of misconduct in 2015. Misconduct is frequent at some of the largest financial firms in the United States. For instance, almost one in five financial advisers at Oppenheimer & Co (CRD #249).[17] have been disciplined for misconduct in the past. A poignant feature of these tables is that several firms with the highest misconduct levels share a parent company with firms that have among the lowest misconduct levels. For example, approximately one in seven advisers at UBS Financial Services have been reprimanded for financial misconduct. At UBS Financial Services affiliate, UBS Securities, the share is ten times smaller: only one in seventy employees have been disciplined for misconduct. One source of differences between these UBS subsidiaries may be their customer base. Advisers at UBS Financial Services help retail customers with personal investment decisions. Advisers working for UBS Securities likely work on a trading desk and deal with institutional rather than retail clients.

These results suggest misconduct varies across observable firm dimensions. We explore whether observable firm characteristics are correlated with new acts of misconduct using the following specification:

$$\begin{aligned} Firm_Misconduct_{jt} &= \beta_0 + \beta_1 Firm_Misconduct_{jt-1} + \beta_2 Executive_Misconduct_j \\ &\quad + \beta X_{jt} + \mu_t + \sum_{s=1}^{50} \mu_s State_{js} + \varepsilon_{jt} \end{aligned}$$

[17] When asked about the results from this study, Oppenheimer, had confirmed that they had "made significant investments to proactively tackle risk and compliance issues in our private client division. We've made changes in senior leadership, branch managers, and significant changes in our advisor ranks." (http://www.bloomberg.com/news/articles/2016-03-01/it-just-got-even-harder-to-trust-financial-advisers) [accessed on March 1, 2016]

The dependent variable $Firm_Misconduct_{jt}$ measures the share of financial advisers working at firm j that are disciplined for misconduct at time t. We include two variables that might shed light on the firm's tolerance toward misconduct. First, $Firm_Misconduct_{jt-1}$ measures the incidence of misconduct in the previous year. Second, $Executive_Misconduct_j$ is a dummy variable indicating that one or more of the firm's owners or executives has been disciplined for misconduct. We control for other dimensions of the firm such as its ownership structure, size, and quality. Our primary specification includes time fixed effects μ_t to absorb aggregate variation in misconduct, and state fixed effects μ_s for each state a firm operates in to control for differences in regulation and demographics.[18]

The results reported in Table 7 show that observable firm characteristics predict firm-level misconduct. The estimates in column (2) indicate that misconduct is 50% more likely in firms in which an owner or executive has been disciplined for misconduct in the past. The results in Table 7 also suggest that more established, older firms engage in less misconduct. We acquire data on the desirability of a firm using CVs in the database of a leading social networking website for professionals, assuming that firms with fewer followers are less desirable. More desirable or popular firms have lower incidence of misconduct on average. It is intuitive that more desirable, established firms that are run by executives with clean records are less likely to generate misconduct. It is important to keep in mind that in this section we use correlations to merely describe the data, and that the causality may be reversed. For example, we would expect a firm that employs better financial advisers is more popular and long lived.

As with adviser-level misconduct, past firm misconduct predicts future misconduct. The coefficient of 0.147 suggests that a 1pp increase in the share of advisers who were disciplined in the previous year is correlated with a 0.147pp increase in new misconduct. Given that past offenses predict misconduct at the adviser level, it should not be surprising that they do so at the firm level as well. However, these results imply that differences in misconduct across firms are persistent. One might think that firms in this market randomize on the amount of misconduct: sometimes they are clean, and at other times they are not. In such a scenario, it would be difficult for customers to avoid misconduct in the long run. Our results suggest that this is not the case. Differences in misconduct across firms do not vanish in the span of a year.

4 Consequences of Misconduct

In this section we examine the consequences of misconduct for financial advisers. What punishment should we expect for misconduct? One benchmark is extreme punishment of misconduct at the firm and industry levels. Firms, wanting to protect their reputation for honest dealing, would fire advisers who engage in misconduct. Other firms would have the same reputation concerns and would not hire such advisers. Then, advisers would be purged from the industry immediately following misconduct, and only advisers with a clean record would survive in equilibrium. Casual observation suggests that the market for academic misconduct

[18] A firm can operate in several states at the same time.

operates in such a fashion: an academic who falsifies research is generally fired from his or her institution and has no employment opportunities in academia.

The alternative benchmark is extreme tolerance of misconduct. Firms would not fire advisers who engage in misconduct, and employees with misconduct would not be penalized when looking for a new job. One could call this the "Zingales" benchmark, in which misconduct is a "feature of the industry, not a bug." Of course, we expect reality to fall somewhere between these benchmarks. We use the panel structure of our data to investigate how firms punish misconduct, and how advisers' misconduct records affect their employment dynamics.

4.1 Firm and Industry Discipline

The substantial presence of repeat offenders implies that the industry does not immediately purge advisers who have engaged in misconduct. We begin our analysis with a simple cut of the data. We examine average turnover rates among advisers with and without instances of misconduct in a given year in Table 8a. Misconduct is strongly correlated with job separation at the firm level. In the year following a misconduct disclosure, 48% of advisers leave their current job. This is substantially higher than the 8.92% rate for advisers with no instances of misconduct. Among advisers who leave their firm following misconduct, 44% are able to find employment within the same year. Their reemployment prospects are only slightly worse than the 52% reemployment rate of advisers who left their firms with no instances of misconduct. These preliminary results suggest that firms are relatively strict: roughly half of the advisers leave their firm in the year following misconduct. However, the industry undoes some of these effects. In particular, only about one-quarter of advisers leave the industry in the year following misconduct. The other three-quarters stay in the industry. Below, we examine these patterns in more detail, and then document which firms hire advisers with misconduct records in Section 4.2.

4.1.1 Firm Discipline

In this section we explore the relationship between job separation and misconduct at the firm-level in more detail. To evaluate firm level discipline, we would ideally compare employment outcomes of an adviser who engaged in misconduct to that of an otherwise identical adviser at same firm at the same time. We approximate this design as closely as possible by estimating the following linear probability model:

$$Separation_{ijlt+1} = \beta_0 + \beta_1 Misconduct_{ijlt} + \beta X_{it} + \mu_{jlt} + \varepsilon_{ijlt}$$

Observations are at the adviser by year level; i indexes an adviser who worked for firm j at time t in county l. The dependent variable $Separation_{ijlt+1}$ is a dummy variable indicating that the adviser is *not* employed at firm j in year $t+1$. The independent variable of interest, $Misconduct_{ijlt}$, is a dummy variable indicating that the adviser had engaged in misconduct in year t.

We control for adviser characteristics such as experience and qualifications in X_{it}. To control for differences in products or clients across firms, we include firm by year by county fixed effects μ_{jlt}. For example, if employees of firms that are associated with more misconduct are more likely to switch jobs in a given year, then this correlation will be absorbed by the fixed effect. This fixed effect also absorbs any aggregate variation in the amount of misconduct and job separations. The fixed effects also captures any variation in regulatory conditions (subsuming any state-level regulatory variation), demographics, and local labor market conditions. In effect, we compare the outcomes of financial advisers who were employed at the same firm at the same time in the same county, but either did or did not engage in misconduct.

We present the estimates in Table 8b. In each specification we estimate a positive and statistically significant relationship between misconduct in year t and job separation in year t+1. The coefficient ranges from 0.24 to 0.31 across specifications with different controls and fixed effects. The coefficient of 0.31 implies that all else equal, misconduct is associated with a 31pp-higher chance of a job separation. These estimates are consistent with the simple summary statistics presented in Table 8a that suggested that advisers who are disciplined for misconduct have a 29% (48-19%) higher probability of separation. This increase is two and a half times the mean separation rate in the data, suggesting that on average, firms discipline misconduct quite heavily.

In Figure 4 we showed substantial differences in damages advisory firms pay as compensation for misconduct, ranging from tens to hundreds of thousands of dollars. One might expect more severe misconduct to be punished more severely. We restrict our attention to instances of misconduct for which we observe damages paid and estimate the following linear probability model:

$$Separation_{ijlt+1} = \beta_0 + \beta_1 \ln Damages_{ijlt} + \beta X_{it} + \mu_j + \mu_l + \mu_t + \varepsilon_{ijlt}$$

$Damages_{itjl}$ measures the total sum paid out by adviser j's firm in year t to the client as the result of settlements and awards due to misconduct. The inclusion of firm, year, and county fixed effects implies that we are comparing job separation probabilities of advisers who engaged in misconduct at the same firm, in the same location, at the same time, but whose misconduct resulted in different damages.

Table 9a displays the results. We find a positive relationship between damages and the probability of a job separation in each specification. A coefficient of 0.0099 indicates that doubling of the awards paid to a client increases the probability that the adviser loses his or her job by approximately 1pp. Moving from the 25^{th} to the 75^{th} percentile of the distribution of settlements is associated with a 10pp-increase in job separations. This is a substantial increase relative to the unconditional mean separation rate of 19pp. The results suggest that firms don't discipline randomly, but rather deliberately assess the extent of misconduct before making a termination decision.

4.1.2 Industry Exit and Reemployment

Based on separation rates following misconduct, the average advisory firm seems to discipline employee misconduct quite severely. Yet, there is a high rate of repeat offenders in the population of financial advisers. One simple statistic that reconciles this seeming contradiction is that 44% of advisers who were separated from their job following misconduct find another job in the industry in the same year (Table 8a). This implies that roughly one-quarter (27%) of financial advisers leave the industry after misconduct. Given that 9% of financial advisers leave the industry every year, the disciplining mechanism at the industry level seems to be substantially less severe than suggested by the 48% separation rate at the firm level.

As the summary statistics suggest, using job separation alone to evaluate the success of "market discipline" is not sufficient, because a significant share of advisers who leave their firm upon misconduct find employment with a new firm. We examine the likelihood that misconduct leads to industry exit or new employment using the following linear probability models:

$$Industry_Separation_{ijlt+1} = \beta_0 + \beta_1 Misconduct_{ijlt} + \beta X_{it} + \mu_{jlt} + \varepsilon_{ijlt}$$

$Industry_Separation_{ijlt+1}$, is a dummy variable equal to one if the adviser i is not employed as a financial adviser in the industry in year $t+1$ where j and l indicate the adviser's firm and county at time t. We again control for adviser characteristics in X_{it}, firm (original firm at time t) by year by county fixed effects μ_{jlt}. In effect, we compare the outcomes of financial advisers who were employed at the same firm, at the same time, in the same county, but either did or did not engage in misconduct. The results for industry separation are reported in Table 8c. We estimate a positive and significant relationship between misconduct and the probability an adviser leaves the industry in each specification. The coefficient for misconduct ranges from 0.18 to 0.20. The estimates in column (2) imply that, all else equal, being disciplined for misconduct at time t is associated with a 20pp higher probability of leaving the industry at time t+1. These estimates imply that advisers who are disciplined for misconduct are three times as likely to leave the industry in the following year relative to advisers who were not disciplined.[19]

The advisers who are separated from their job but do not leave the industry find employment with another advisory firm. To understand the differences in reemployment prospects of advisers with misconduct, we estimate the following specification:

$$New_Employment_{ijlt+1} = \beta_0 + \beta_1 Misconduct_{ijlt} + \beta X_{it} + \mu_{jlt} + \varepsilon_{ijlt}$$

in which we restrict the sample to financial advisers who were separated from their job in the previous year.

[19] One might be concerned that perhaps the advisers in the control group are not well matched with those who engage in misconduct. In subsequent analysis we focus on firms in which all advisers were forced to look for new employment because the firm was dissolved- for example, because it was going out of business. The difference from this test is that all advisers have to find new jobs, regardless of their past misconduct or quality. Therefore, we compare the employment outcomes of the average employee with misconduct to the average employee without misconduct. This analysis is reported in Table 12b.

$New_Employment_{ijlt+1}$ is equal to one if the adviser i remains in the industry but has switched employers between time t and $t+1$. Table 8c shows a negative and significant relationship between misconduct and the probability an adviser finds new employment firms. Our results imply that relative to other advisers looking for jobs, advisers who are disciplined at time t are $8-10$pp less likely to find a new job in the next year. To put these estimates in perspective, the average probability an adviser will be reemployed is just over 50%. Overall, financial advisers' reemployment prospects are somewhat worse following misconduct, but the high reemployment rate allows approximately three-quarters of them to stay in the industry in the year following misconduct.

As we show previously, advisers whose misconduct results in higher damages have an elevated probability of losing their job. Does the labor market recognize the extent of cases of misconduct that lead to job separation? We examine whether larger damages lead to more industry exit and smaller reemployment prospects of advisers. We estimate the following linear probability model:

$$y_{ijlt+1} = \beta_0 + \beta_1 \ln Damages_{ijlt} + \beta X_{it} + \mu_{jlt} + \varepsilon_{ijlt}$$

As before, we examine two specifications with different dependent variables, $Industry_Separation_{ijlt+1}$, and $New_Employment_{ijlt+1}$. Table 9b displays the results. The reemployment prospects of advisers whose misconduct resulted in larger damages are worse, even when comparing advisers who engaged in misconduct at the same firm, at the same time, in the same county, and with the same observable characteristics. They are more likely to exit the industry, and less likely to find employment with another firm. These results suggest that the labor market for financial advisers is somewhat discerning when it comes to employing financial advisers with a history of misconduct; the labor market accounts for the extent of misconduct to some degree. Overall, the industry eliminates some advisers following misconduct, but is substantially less strict than firms individually. The reallocation of financial advisers to new firms partially blunts the firm-level response to misconduct. One puzzle that remains is why some firms are willing to hire advisers who were fired by other firms for misconduct.

4.2 New Employment

We document a relatively high rate of reemployment among advisers who lost their job following misconduct. One may argue that this evidence suggests that the cost of misconduct in the industry as a whole is low. On the other hand, just because an adviser is reemployed, it does not mean that misconduct is costless. Advisers lose income during temporary unemployment, and it may take effort to find jobs. Moreover, it is possible that when such advisers do find a job, the job is worse (i.e., at a less prestigious and/or worse-paying firm). Here we examine the duration of unemployment spells following misconduct, as well as the characteristics of firms that hire advisers following misconduct. The reallocation of advisers across firms will help us better understand the costs of misconduct for financial advisers, as well as why some financial advisory firms are

willing to hire advisers who were fired elsewhere.

4.2.1 Unemployment Duration

We first examine unemployment duration studying the 1,350,000 unemployment spells in our data set. Figures 7a and 7b display the unemployment survival function for financial advisers who were and were not reprimanded for misconduct in the year preceding their unemployment spell. Figure 7a indicates 47% of advisers who were reprimanded for misconduct remain unemployed after twenty-four months. In contrast, 45% of advisers who were not reprimanded remain unemployed for the same duration. Overall, unemployment spells of advisers following misconduct are longer than those of other advisers who suffer unemployment spells that were not preceded by misconduct. A back-of-the-envelope calculation suggests that the costs amount to more than one month's worth of wages in present value terms.[20]

The simple non-parametric survival analysis in Figures 7a and 7b does not account for other differences among financial advisers, such as their experience or qualifications. We formally analyze the impact of misconduct on an adviser's job search by estimating the following Cox proportional hazards model:

$$\lambda_{it}(\tau) = \lambda_0(\tau) exp\left(\gamma Misconduct_{it-1} + \beta X_{it} + \mu_t\right) \tag{1}$$

where $\lambda_i(\tau)$ is the hazard rate of finding new employment in the industry for individual i conditional on being unemployed for τ months. The hazard rate is a function of the baseline hazard $\lambda_0(\tau)$ and changes proportionally depending on whether the financial adviser was reprimanded for misconduct in the year preceding the unemployment spell, $Misconduct_{it-1}$, and the characteristic X_{it}. We also include time fixed effects μ_t to account for aggregate fluctuations in the employment market.

The results presented in Table 10 coincide with the summary statistics displayed in Figures 7a and 7b. The estimates in the table are reported in terms of hazard ratios. Any reported hazard ratio less than one suggests that the covariate is correlated with longer unemployment spells. The estimates in our main specifications (columns (1) and (2)) suggest that an unemployed adviser who had engaged in misconduct in the year prior to the start of his or her unemployment spell has a 17pp-smaller chance of finding new employment in the industry at any given moment in time relative to an adviser without recent misconduct. In columns (3) and (4) we restrict our data to unemployment spells of advisers who ultimately found a new job in the industry. Conditional on finding a job, advisers recently disciplined for misconduct find these jobs at a marginally faster rate relative to those advisers without recent misconduct. The results suggest that the observed longer unemployment spells for advisers with recent misconduct are driven by advisers who are not rehired in the industry after losing their previous employment. This finding is consistent with the simple summary statistics displayed in Figures 7a and 7b.

[20] We calculate the present value of lost wages using the empirical survival function under the assumption that no adviser remains unemployed after five years.

4.2.2 Who Hires Offenders?

Approximately 44% of advisers who engage in misconduct and are separated from their job find new jobs as financial advisers within a year. We are broadly interested in two issues. First, we want to better understand the change in job quality that follows misconduct. If misconduct leads to a substantially worse job, then it is costlier than suggested by the reemployment statistics. Second, we are interested in why misconduct can persist in this market, and seeing who hires advisers with misconduct may offer a window into the mechanism at work.

We compare advisers who switched jobs following misconduct to other advisers who switched jobs from the same firm at the same time. Therefore, the advisers from the control group face the same labor market, under the same regulatory rules, exposed to the same shocks, as the adviser who engaged in misconduct. Further, because they were employed at the same firm, any firm-specific shocks or adviser characteristics which selected them into these firms are also accounted for. We estimate the following specification:

$$New_Firm_Characteristic_{ijt} = \beta_0 + \beta_1 Misconduct_{ijt} + \mu_{jt} + \varepsilon_{ij}$$

The dependent variable measures the size, payout, firm desirability, revenue, and the amount of misconduct of the firm adviser i joined after leaving firm j. The dependent variable of interest is $Misconduct_{ijt}$, which is an indicator variable to one if the adviser was disciplined for misconduct in the year prior to leaving firm j. Here we include the previous firm by time fixed effects μ_{jt} and we restrict the data set to only those firms in which we observe advisers with and without misconduct who switch firms from firm j.[21] In other words, we restrict the sample to only those firms j where we observe variation in $Misconduct_{ij}$.

Table 11 displays the results. Relative to other advisers who left the same firm at the same point in time, advisers with misconduct are hired in firms that pay almost $15,000 less per year. We acquire data on the desirability of a firm using CVs in the database of a leading social networking website for professionals, assuming that firms with fewer followers are less desirable. Advisers move to substantially less popular firms following misconduct. Misconduct is costly even for advisers with a new job, both in monetary terms as well as in compensating differentials.

These results also help us understand why firms employ advisers who were fired from other firms following misconduct. These firms differ from firms that would otherwise employ these advisers, in terms of compensation as well as prestige. Importantly, these firms are more willing to employ advisers with misconduct records. We observe that, relative to other advisers who left the same firm at the same time, advisers who engaged in misconduct are hired by firms that employ other advisers with past misconduct records. In other words, after losing their job following misconduct, advisers are rematched with a firm that is less concerned with misconduct. These firms are on average substantially smaller in dimensions of advisers, revenues, and assets under management. If firms were identical, they would not hire advisers who were fired from other

[21] In Appendix A1 we replicate this analysis with original firm by time by county fixed effects and find similar results.

firms. "Matching on misconduct" can rationalize why discipline is severe at the firm level, but substantially blunter at the industry level.

4.3 Alternative Specifications Using Firm Dissolution

In the analysis above we need to construct a control group for advisers who engaged in misconduct and switched jobs. The control group consists of advisers who were employed at the same firm, in the same location, at the same time who also switched jobs. One might be concerned that the control group does not accurately represent the average adviser at the firm. Advisers who switch jobs with a clean misconduct record could do so because better employment opportunities came along. Then they would be better than the average employee at the firm. Alternatively, it is, on average, worse advisers who leave the firm. In order to address this concern, we focus on firms in which all advisers were forced to look for new employment because the firm was dissolved- for example, because it was going out of business. We compare employment outcomes of advisers from the same firm with and without misconduct, after the firm dissolves. The difference from our previous test is that all advisers have to find new jobs, regardless of their past misconduct or quality. Therefore, we are comparing the employment outcomes of the average employee with misconduct to the average employee without misconduct.

We first examine the probability that advisers will find a new job in the industry after their firm dissolves, following the specification from Section 4.1.2. The corresponding results are reported in Table 12b. We find that advisers with a record of misconduct in the year prior to dissolution are 16pp less likely to find a job in the industry next year relative to other advisers from the same dissolved firm. These results are quantitatively very similar to those from Section 4.1.2, suggesting that the control group we employed is likely not very biased.

We also examine the differences in jobs that advisers with and without misconduct obtain following firm dissolution, mirroring specification in Section 4.2.2. Because of the substantially reduced sample, we have very few observations of new employment for which data on compensation, assets, revenues or desirability is available, so we cannot perform the analysis on those dimensions. We do have data on firm size and firm misconduct for all firms. The results are reported in Table 12a and mirror those from Table 11. We find sorting of employees along the dimension of firm misconduct. Advisers who were disciplined for misconduct in the year prior to dissolution move to firms with a higher share of other advisers with records of misconduct in the past. We also find that advisers with misconduct records move to firms with fewer employees relative to advisers without misconduct records. Overall, these results confirm that the choice of control group does not seem to be driving our results.

5 Why Is Misconduct Heterogeneous in Equilibrium?

The results in Section 3 indicate that firms and advisers with clean records coexist with firms and advisers who persistently engage in misconduct. Section 4 illustrates that engaging in misconduct is costly for advisers, but not sufficiently for it to eliminate repeat offenders. Part of the reason is that advisers who lose their jobs following misconduct are reemployed by firms that engage in more misconduct. Given that the disciplinary record of every financial adviser in the United States is public record, why does reputation not drive out bad advisers or firms, which employ them?

We pursue two lines of inquiry. We first focus on differences in firms' tolerance of misconduct. The previous section shows that advisers with misconduct sort to different firms than advisers without misconduct. We examine whether firms' tolerance of misconduct differs when it comes to their hiring and firing decisions. Differences in hiring policies address *how* firms maintain different adviser pools over time, but does not explain why consumers keep coming back to firms with substantial misconduct.

One potential reason why firms with a bad reputation can survive is if some customers are not very sophisticated. Such customers either do not know where to access financial adviser disclosures, do not know how to interpret them, or do not know that such disclosures even exist. If there are differences in consumer sophistication, then the market can be segmented. Some firms "specialize" in misconduct and attract unsophisticated customers, and others cater to more sophisticated customers, and specialize in honesty, in the spirit of Stahl (1989) and Carlin (2009). The second part of our analysis examines this possibility by relating financial adviser misconduct to the sophistication of their potential customers.

5.1 Tolerance for Misconduct

5.1.1 Differences in Firing

The summary statistics presented in Section 3 suggest that some firms employ substantially more dishonest employees than other firms: the standard deviation in the firm share of employees with prior misconduct is 17pp. One possible reason is that some firms may be more tolerant of misconduct than others, and are less likely to fire such employees. We investigate this hypothesis by exploring whether firms with a larger share of misconduct are more tolerant toward new misconduct by using the following specification:

$$\begin{aligned} Separation_{ijlt+1} &= \beta_0 + \beta_1 Misconduct_{ijlt} + \beta_2 Firm_Misconduct_{jt} \times Misconduct_{ijlt} \\ &\quad + \beta_4 X_{it} + \mu_{jlt} + \varepsilon_{ijlt} \end{aligned}$$

We build on the specification in Section 4.1.1. The dependent variable $Separation_{ijlt+1}$ is a dummy variable indicating whether or not financial adviser i, in county l, working at firm j, left her firm at time t+1. The variable $Misconduct_{ijlt}$ is a dummy variable indicating whether or not an adviser was disciplined at time t. The key coefficient of interest is the interaction term $Firm_Misconduct_{jt} \times Misconduct_{ijlt}$. The coefficient

β_2 then measures the sensitivity to misconduct across firms. As in Section 4.1.1, we employ firm by year by county fixed effects, which absorb, among other confounds, the differences in firm level misconduct, $Firm_Misconduct_{jt}$.

We present the estimates corresponding to the above specification in column (1) of Table 13a. We estimate a negative and significant coefficient on the interaction term $Firm_Misconduct_{jt} \times Misconduct_{ijlt}$. The coefficient estimate of -1.3. suggests that firms that employ more employees with records of misconduct, are also less likely to punish additional misconduct. Advisers who engage in misconduct at a firm, which is three-quarters of a standard deviation (0.13) above the mean in misconduct (0.07), have only a 2pp higher probability of being separated from their job than advisers who did not engage in misconduct. This sensitivity is almost 27pp lower than that of an average firm. These results suggest that firms that employ advisers with prior offenses are also less likely to fire advisers for new offenses. A greater tolerance for misconduct should make these firms more attractive to advisers with a propensity to engage in misconduct, such as advisers with misconduct records.

5.1.2 Differences in Hiring

We now explore if firms also differ in their tolerance for misconduct in hiring decisions. In particular, we ask if some firms are more likely to hire advisers that have been previously disciplined for misconduct. We do so by investigating the composition of newly hired advisers using the following specification:

$$Share_of_New_Hires_Disciplined_{jt+1} = \beta_0 + \beta_1 Firm_Misconduct_{jt} + \mu_s + \mu_t + \varepsilon_{jt}$$

The dependent variable reflects the share of new employees that were hired by firm j at time t+1 that were disciplined at time t. The independent variable $Firm_Misconduct_{jt}$ reflects the percentage of advisers working at firm j that were disciplined at time t. The corresponding estimates are reported in Table 13b. Firms with higher incidences of misconduct at time t hire a larger share of advisers at time t+1 who were disciplined for misconduct at time t. The coefficient estimate in column (1) indicates that a one-percentage-point increase in a firm's misconduct rate at time t is associated with a 0.37pp higher incidence of misconduct among new hires. Overall, the results presented in Tables 13a and 13b suggest that firms with higher incidences of misconduct are more tolerant of misconduct in their hiring and firing decisions.

5.2 Customer Base and Incentives

In this section we explore whether firms that specialize in market segments with less sophisticated investors, also engage in more misconduct. Such segmentation would provide one possible reason why firms that persistently engage in misconduct can survive in the market next to firms that have relatively clean records.

5.2.1 Retail Clients, Fee Structure, and Misconduct

The Investment Company Act of 1940 considers high net worth individuals "qualified purchasers,"[22] to be more sophisticated than smaller retail investors, allowing them substantially more latitude in their investments. One might expect misconduct to be directed at less sophisticated investors, who are easier to ensnare. Alternatively, defrauding large investors may be more profitable, since they have more wealth. In this section we use additional information on the client base as well as fee structures across investment advisory firms, and relate them to misconduct. We gather data from the SEC's Form ADV. In these filings, advisory firms disclose information on the clientele and business practices. Since not all financial advisory/brokerage firms are registered as investment advisory firms, we only observe the Form ADV filings for 405 unique firms in our data set over the period 2011-2014.

We formally examine how the client base and fee structure of financial advisory firms correlate with misconduct. We estimate the following specification:

$$Firm_Misconduct_{jt} = \beta_0 + \beta_1 Retail_Firm_{jt} + \sum_{k=1}^{K} \beta_k Compensation_Structure_{kjt} + \varepsilon_{jt}$$

The key independent variable of interest is a dummy variable, $Retail_Firm_{jt}$, that indicates whether or not firm j serviced retail clients (non-high net worth individuals, families, and households) in year t.[23] We also control for a set of dummy variables, $Compensation_Structure_{kjt}$, that measure how the advisory firm charges for its different services. The various compensation structures k include hourly fees, fixed fees, fees based on assets under management, commissions, and performance. The compensation structures are not mutually exclusive, and many firms use a variety of methods to charge for services.

We present two different measures of $Firm_Misconduct_{jt}$. First, we measure it as the likelihood the firm engages in new misconduct, measured as the share of advisers working for firm j that are disciplined at time t. The second measure relates to the types of advisers the firm employs, measuring the share of advisers working for firm j that have been ever been disciplined at or prior to time t. Table 14 shows that firms that advise retail clients are 0.2pp more likely to engage in new misconduct. Relative to the mean rate of new misconduct of 0.6pp, this is a substantial increase. Similarly, firms that advise retail clients are 3pp more likely to employ an adviser who has been previously disciplined for misconduct (Table 14). We also find evidence that firms that charge hourly or based on assets under management are more likely to engage in new misconduct, and have a higher stock of advisers who have engaged in misconduct in the past. These results suggest that there is some market segmentation on misconduct, which is more likely targeted at unsophisticated retail investors.

[22] Section 2(a)(51)(A) of the Investment Company Act of 1940.

[23] High net worth individuals are "qualified purchasers" according to the definition of Section 2(a)(51)(A) of the Investment Company Act of 1940.

5.2.2 Firm Location and Customer Base

An alternative way to measure the sophistication of firms' customer base is to study the population characteristics of markets in which the firm is located. Tables 15a and 15b report the counties with the highest and lowest rates of misconduct among those counties with at least one hundred registered advisers. Almost one in three advisers in Madison County, New York, have been disciplined for misconduct, relative to only one in thirty-eight advisers in Franklin County, Pennsylvania. Figure 8 supports the idea of substantial geographic differences in misconduct: Florida, Arizona, and California have some of the highest incidences of financial misconduct, while the rates are lowest in the Midwest. We next examine whether misconduct is more prevalent in markets with a larger share of individuals who are often deemed less financially sophisticated, such as older, less educated individuals (see Hall and Woodward 2012; Gurun, Matvos, and Seru 2015). To do so, we investigate whether this variation is explained by observable county characteristics using the following specification:

$$Misconduct_Rate_{lst} = \beta X_{lst} + \mu_t + \mu_s + \varepsilon_{lst}$$

The unit of observation is at the county by year level. We use two definitions of the dependent variable $Misconduct_Rate_{lst}$. The first is defined as the share of new misconduct, measured as the percentage of advisers living in county l and state s that are disciplined at time t. The second measures which types of advisers are employed in different counties, defined as the percentage of advisers living in county l and state s who were ever disciplined at or prior to time t. The independent variables of interest are measures of financial sophistication, such as education and the share of retirees in the population. We also control for other county demographic characteristics that may be correlated with demand for financial advice, such as income (log median household income) and population size. We control for time fixed effects μ_t to absorb aggregate variation in misconduct, and include state fixed effects μ_s to account for regulatory differences across states, which may lead to different amounts of misconduct.[24]

The results are reported in Table 15c. We find that counties with a smaller share of college graduates and a larger share of retirees experience more misconduct, and employ more advisers with past misconduct records. The estimates suggest that a 10pp increase in the number of individuals older than 65 is correlated with an approximately 0.26pp increase in the percentage of advisers who are disciplined for misconduct in a given year. Similarly, a 10pp increase in the share of college-educated individuals decreases the misconduct rate by approximately 0.1%. These estimates are substantial relative to the mean misconduct rate of 0.6%. Overall, these results suggest that financial misconduct is more prevalent in areas with a less financially sophisticated, older population and less educated individuals. We also find a correlation between demographics, which would proxy for demand for financial advice, and misconduct. Higher-income counties, for example, experience more misconduct. Overall, our results support the notion that the presence of financially

[24] To help rule out potential outliers, we restrict the data set to counties with at least 50 advisers. The results presented in the table are not sensitive to this criterion. Due to the availability of data, we estimate our specification at the county by year level using an unbalanced panel of 667 counties over the period 2010-2013.

unsophisticated investors allows misconduct to persist in the market for financial advice.

6 Robustness and Extensions

We now discuss the robustness and several extensions of our findings. For brevity, we relegate a few additional robustness checks to an online Appendix. We start by exploring categories of disclosure that we did not classify under misconduct. We conservatively categorize only six of twenty-three categories of disclosure as misconduct, focusing on categories for which misconduct is clear. However, statistically, one would expect other disclosures to also be somewhat indicative of misconduct. For example, an adviser engaged in a pending consumer dispute is more likely to have engaged in misconduct than an adviser who was not involved in a dispute in the first place.

We now explore whether other disclosures predict advisers' future misconduct. We reestimate regressions from Section 3 on predicting adviser misconduct, but include all disclosure categories. Results in Table 16 show that each disclosure category that we classify as misconduct is correlated with higher incidences of misconduct in the future. Interestingly, several "Other Disclosures" categories also predict future misconduct to some extent, suggesting that disclosing these categories may be valuable to potential consumers trying to avoid misconduct.

Next, we explore whether firms fire advisers following different disclosure categories. The results in column (2) suggest that each individual misconduct category is correlated with higher incidences of job separation. On the other hand, firms are not more likely to fire advisers if consumer complaints were dismissed or withdrawn, and we therefore did not classify such cases as misconduct. The coefficient has a negative sign and is economically very small and statistically indistinguishable from 0. We do find that disclosures where a customer dispute was denied or closed do lead to increased job separation probability. These results suggest that perhaps our categorization of misconduct is bit conservative. Overall, other disclosures predict some future misconduct, and advisory firms seem to partially account for that in their firing decisions.

Finally, in column (3), we reestimate the Cox proportional hazard model to assess unemployment duration for advisers who lost their job following a disclosure. For each category of disclosure we categorize as misconduct, the coefficient is statistically different from 1. Interestingly, while most of these categories imply longer unemployment outcomes, some categories – in particular, criminal case and customer dispute settlement – do see faster employment outcomes. This might be the case since in situations like these, the adviser might have started looking for job well in advance, once it was clear that he or she might have to leave his or her existing firm consequent to the misconduct being discovered.

We also examine how the incidence and consequences of misconduct may vary across investment advisers and non-investment advisers. Approximately half of currently registered financial advisers are also registered as investment advisers. As we discuss in Section 2, investment advisers face different legal and regulatory requirements from non-investment advisers, such as brokers, and provide different services to potentially

different clienteles. In Table A3 we reestimate our main specifications separately for investment advisers and non-investment advisers. The main results hold for both populations, but to differing degrees. We find that investment advisers are more likely to be disciplined for misconduct, but face less punishment at both the industry and firm levels. These differences could be driven by heterogeneity in consumer sophistication. Investment advisers may be more likely to deal with retail rather than institutional clients.

7 Conclusion

We document substantial misconduct among United States financial advisers. More than 12% of financial advisers have a disclosure on their record, and approximately 7% have been disciplined for misconduct and/or fraud. The costs of misconduct are not small: the median settlement amount is $40,000. Misconduct varies dramatically across advisers and firms, and repeat offenders are common. Although advisers face consequences for misconduct, the majority of advisers remain in the industry following misconduct. More than 50% remain with the same firm after a year, and 20% switch to a different firm in the industry. However, it takes longer for reprimanded advisers to find a position, and when they do, they usually move to smaller, lower-paying firms. The firms that hire advisers after misconduct-driven separation have higher rates of prior misconduct. This "match on misconduct" reemployment undermines the disciplining mechanism in the industry, lessening the punishment for misconduct.

The incidence of misconduct varies systematically across firms, with the highest incidence at some of the largest financial advisory firms in the United States. We find evidence suggesting that some firms "specialize" in misconduct. Such firms are more tolerant of misconduct, hiring advisers with unscrupulous records. These firms also fire advisers who engage in misconduct to a lesser degree. We argue that heterogeneity in consumer sophistication could explain the prevalence and persistence of misconduct at such firms. Our results suggest that misconduct is widespread in regions with relatively high incomes, low education, and elderly populations. These results suggest that firms that specialize in misconduct with several unscrupulous financial advisers are likely targeting vulnerable consumers, while other firms use their reputation to attract sophisticated consumers.

Our estimates likely understate the true extent of misconduct in the industry for several reasons. First, we do not classify pending consumer complaints as misconduct. Second, while we show that the average penalty for cases in the data is large, the penalties themselves are decided by arbitration committees, which have been accused of being favorable to the industry.[25] Third, if some advisers do not have an opportunity to engage in misconduct, because of their job assignment, then our estimates will be a lower bound for misconduct among those advisers that have the opportunity to do so, for example, when interacting with clients. Finally, our numbers would also be a lower bound if adverse information about advisers may have

[25] http://www.nytimes.com/2014/07/19/your-money/a-closer-look-at-the-arbitration-process-for-investors.html?_r=0 [accessed on March 8, 2016]

been removed in some instances.[26]

Our findings suggest that current structure of penalties or reputation concerns may not be sufficient to deter advisers from repeatedly offending. A natural policy response aimed at lowering misconduct would be to increase market transparency, and in policies aiding unsophisticated consumers access more information. Several recent efforts by regulators, such as the establishment and promotion of FINRA's BrokerCheck website, have been along these lines. In addition, other policy proposals such as the Department of Labor initiative, which would mandate a fiduciary standard for those financial advisers who have not been subject to it at this point, as well as proposals to increase penalties for misconduct could also potentially decrease financial misconduct.

[26] http://dealbook.nytimes.com/2014/09/25/a-murky-process-yields-cleaner-professional-records-for-stockbrokers/ [accessed on March 1, 2016]

References

Agarwal, Sumit, Souphala Chomsisengphet, Neale Mahoney, and Johannes Stroebel. 2014. "Regulating Consumer Financial Products: Evidence from Credit Cards." Forthcoming in *Quarterly Journal of Economics.*

Agarwal, Sumit, John C. Driscoll, Xavier Gabaix, and David Laibson. 2009. "The Age of Reason: Financial Decisions Over the Life Cycle with Implications for Regulation." *Brookings Papers on Economic Activity,* 2009(2): 51-117.

Agrawal, Anup, Jeffrey F. Jaffe, and Jonathan M. Karpoff. 1999. "Management Turnover and Governance Changes Following the Revelation of Fraud." *The Journal of Law & Economics* 42(1): 309-342.

Anagol, Santosh, Shawn Cole and Shayak Sakar. 2012. "Understanding the Incentives of Commissions Motivated Agents: Theory and Evidence from the Indian Life Insurance Market." Working Paper.

Barwick, Panle Jia, Parag A. Pathak, and Maisy Wong. 2015. "Conflicts of Interest and the Realtor Commission Puzzle." NBER Working Paper No. w21489.

Becker, Gary S. 1968. "Crime and Punishment: An Economic Approach." *Journal of Political Economy,* 76: 169-217

Bergstresser, Daniel, John M. Chalmers, and Peter Tufano. 2009. "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry." *Review of Financial Studies*, 22(10): 4129-4156.

Campbell, John Y. 2006. "Household Finance." *Journal of Finance,* 61(4): 1553–1604.

Campbell, John Y., Howell E. Jackson, Brigitte C. Madrian, and Peter Tufano. 2010. "The Regulation of Consumer Financial Products: An Introductory Essay with Four Case Studies." HKS Faculty Research Working Paper Series RWP10-040.

Campbell, John Y., Howell E. Jackson, Brigitte C. Madrian, and Peter Tufano. 2011. "Consumer Financial Protection." *Journal of Economic Perspectives,* 25(1): 91–114.

Carlin, Bruce I. 2009. "Strategic Price Complexity in Retail Financial Markets." *Journal of Financial Economics,* 91(3): 278-287.

Carlin, Bruce I., and Gustavo Manso. 2011. "Obfuscation, Learning, and the Evolution of Investor Sophistication." *Review of Financial Studies*, 24(3): 754-785.

Célérier, Claire and Boris Vallée. 2014. "What Drives Financial Complexity? A Look into the Retail Market for Structured Products." Working Paper.

Chalmers, John and Jonathan Reuter. "Is Conflicted Investment Advice Better than No Advice?" NBER Working Paper No. w18158

Christoffersen, Susan EK, Richard Evans, and David K. Musto. 2013. "What Do Consumers' Fund Flows Maximize? Evidence from their Brokers' Incentives." *The Journal of Finance,* 68(1): 201-235.

Dimmock, Stephen G., William C. Gerken and Nathaniel P. Grahm. 2015. "Is Fraud Contagious? Career Networks and Fraud by Financial advisers." Working Paper

Duarte, Fabian, and Justine S. Hastings. 2012. "Fettered Consumers and Sophisticated Firms: Evidence from Mexico's Privatized Social Security Market." NBER Working Paper No. w18582.

Dyck, Alexander, Adair Morse and Luigi Zingales. 2010. "Who Blows the Whistle on Corporate Fraud." *Journal of Finance,* 65(6): 2213-2253

Dyck, Alexander, Adair Morse and Luigi Zingales. 2014. "How Pervasive is Corporate Fraud?" Rotman School of Managment Working Papering No. 2222608

Egan, Mark. 2015. "Brokers vs. Retail Investors: Conflicting Interests and Dominated Products." Working Paper.

"Exams." NASAA. North American Securities Administrators Association. Accessed August 9, 2015 <http://www.nasaa.org/industry-resources/exams/>

Fama, Eugene F. 1980. "Agency Problems and the Theory of the Firm." *The Journal of Political Economy,* 88(2): 288-307

Fama, Eugene and Michael Jensen. 1983. "Agency Problems and Residual Claims." *The Journal of Law & Economics,* 26(2): 327-349.

Fich, Eliezer M., and Anil Shivdasani. 2007. "Financial fraud, director reputation, and shareholder wealth." *Journal of Financial Economics* 86(2): 306-336.

Gabaix, Xavier, and David Laibson. 2006. "Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets." *The Quarterly Journal of Economics*, 121(1): 505-540.

Garleanu, Nicolae B. and Lasse H. Pedersen. 2015. "Efficiently Inefficient Markets for Assets and Asset Management." NBER Working Paper No. w21563.

Gennaioli, Nicola, Andrei Shleifer, and Robert Vishny. 2015. "Money doctors." *Journal of Finance*, 70(1): 91-114.

Glaeser, Edward L. and Raven E. Saks. 2006. "Corruption in America." *Journal of Public Economics.* 90: 1053-1072.

Griffin, John M. and Gonzalo Maturana. 2014. "Who Facilitated Misreporting in Securitized Loans?" Forthcoming in *Review of Financial Studies.*

Guiso, Luigi, Paola Sapienza, and Luigi Zingales. 2008. "Trusting the stock market." *Journal of Finance*, 63(6): 2557-2600.

Gurun, Umit G., Gregor Matvos and Amit Seru. 2015. "Advertising Expensive Mortgages." Forthcoming in *Journal of Finance.*

Hastings, Justine S., Ali Hortaçsu, and Chad Syverson. 2015. "Advertising and Competition in Privatized Social Security: The Case of Mexico." NBER Working Paper No. w18881.

Hastings, Justine S., and Lydia Tejeda-Ashton. 2008. "Financial Literacy, Information, and Demand Elasticity: Survey and Experimental Evidence from Mexico." NBER Working Paper No. w14538.

Helland, Eric. 2006." Reputational Penalties and the Merits of Class Action Securities Litigation." *The Journal of Law & Economics,* 49(2): 365-395.

Karpoff, Jonathan M., D. Scott Lee, and Gerald S. Martin. 2008. "The consequences to managers for financial misrepresentation." *Journal of Financial Economics,* 88(2): 193-215.

Khanna, Vikramaditya S., E. Han Kim and Yao Lu. 2015. "CEO Connectedness and Corporate Fraud." *Journal of Finance*, 70(3): 1203-1252.

Lusardi, Annamaria, and Olivia S. Mitchell. 2011. "Financial literacy and retirement planning in the United States." *Journal of Pension Economics and Finance*, 10(4):: 509-525.

Mullainathan, Sendhil, Markus Noeth, and Antoinette Schoar. 2012. "The market for financial advice: An audit study." NBER Working PAper No. w17929.

Parsons, Christopher A., Johan Sulaeman and Sheridan Titman. 2014. "The Geography of Finanical Misconduct." NBER Working Paper No. w20347.

Piskorski, Tomasz, Amit Seru and James Witkin. 2015. "Asset Quality Misrepresentation by Financial Intermediaries: Evidence from the RMBS Market." Forthcoming in the *Journal of Finance*

Povel, Paul, Rajdeep Sign and Andrew Winton. 2007. "Booms, Busts, and Fraud." *Review of Financial Studies*, 20(4): 1219-1254.

"Qualification Exams." FINRA. Finanical Industry Regulatory Authority. Accessed August 9, 2015 <http://www.finra.org/industry/qualification-exams>

Srinivasan, Suraj. 2005. "Consequences of financial reporting failure for outside directors: Evidence from accounting restatements and audit committee members." *Journal of Accounting Research*, 43(2): 291-334.

Stahl, Dale O. 1989. "Oligopolistic Pricing with Sequential Consumer Search." *The American Economic Review*, 79(4): 700-712.

Wang, Tracy Yu, Andrew Winton and Xiaoyun Yu. 2010. "Coporate Fraud and Business Conditions: Evidence from IPOs." *Journal of Finance*, 65(6): 2255-2291.

Woodward, Susan E., and Robert E. Hall. 2012. "Diagnosing Consumer Confusion and Suboptimal Shopping Effort: Theory and Mortgage-Market Evidence." *American Economic Review,* 102(7): 3249-3276.

Zingales, Luigi. 2015. "Does Finance Benefit Society." The Journal of Finance, 70(4): 1327-1363.

Table 1: Adviser Summary Statistics

(a) Adviser Summary Statistics

Variable	Obs	Mean	Std. Dev.	Median
Experience (years)	7,946,680	11.25	9.60	9.00
Registration:				
Currently Registered	7,946,680	0.698		
Registered as IA	5,544,727	0.514		
Disclsoures:				
Disclosure (in a year)	7,946,680	0.0162		
Misconduct (in a year)	7,946,680	0.0060		
Disclosure (ever)	7,946,680	0.1273		
Misconduct (ever)	7,946,680	0.0728		
Exams and Qualifications (Series):				
No. Qualifications	7,946,680	2.92	1.37	3.00
Uniform Sec. Agent St. Law (63)	7,946,680	0.771		
General Sec. Rep. (7)	7,946,680	0.680		
Inv. Co. Products Rep. (6)	7,946,680	0.399		
Uniform Combined St. Law (66)	7,946,680	0.213		
Uniform Inv. Adviser Law (65)	7,946,680	0.205		
General Sec. Principal (24)	7,946,680	0.158		

(b) Total Number of Advisers

Rank	County	No. Advisers
1	New York County, NY	89,704
2	Cook County, IL	18,620
3	Los Angeles County, CA	15,969
4	McLean County, IL	12,979
5	Maricopa County, AZ	11,032
6	Harris County, TX	9,429
7	Hennepin County, MN	9,407
8	Suffolk County, MA	9,054
9	Mecklenburg County, NC	8,564
10	Orange County, CA	8,475

(c) Advisers Per Capita

Rank	County	Advisers P.C.
1	McLean County, IL	0.074
2	New York County, NY	0.055
3	St. Louis city, MO	0.022
4	Kenton County, KY	0.012
5	Suffolk County, MA	0.012
6	Chester County, PA	0.011
7	San Francisco County, CA	0.009
8	Mecklenburg County, NC	0.008
9	Denver County, CO	0.008
10	Arapahoe County, CO	0.008

Note: Table 1a displays the summary statistics corresponding to our panel of financial advisers over the period 2005-2015. Observations are adviser by year. We report the standard deviation and median for the non-dummy variables. Tables 1b and 1c display the counties in the U.S. with the greatest number of total advisers and greatest number of advisers per capita as of May 2015. Advisers per capita is calculated using population data from the 2013 American Community Survey (ACS); therefore the ranking of advisers per capita is restricted to the 823 counties covered in the ACS.

Table 2: Financial Advisory Firm Summary Statistics

(a) Largest Financial Advisory Firms

Rank	Firm	Firm CRD#	No. Advisers
1	MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED	7691	32,107
2	WELLS FARGO ADVISORS, LLC	19616	26,308
3	J.P. MORGAN SECURITIES LLC	79	26,251
4	MORGAN STANLEY	149777	23,618
5	LPL FINANCIAL LLC	6413	18,093
6	PFS INVESTMENTS INC.	10111	17,700
7	EDWARD JONES	250	16,750
8	STATE FARM VP MANAGEMENT CORP.	43036	15,089
9	AMERIPRISE FINANCIAL SERVICES, INC.	6363	13,549
10	FIDELITY BROKERAGE SERVICES LLC	7784	12,697

(b) Firm Characeristics

Variable	No. Firms	Obs	Mean	Std. Dev.	Median
BrokerCheck Data:					
Investment Advisory Firm	4,178	36,856	0.24		
Affiliated w/ Fin. Inst.	4,178	36,856	0.54		
Ref. Arrang. w/ other Brokers	4,178	36,856	0.45		
No. Business Lines	4,178	36,856	5.99	4.56	4
No. Regulatory Memberships	4,178	36,856	1.57	2.18	1
Firm Age	4,178	36,856	15.17	13.39	12
No. States Operated In	4,178	36,856	23.51	20.61	16
Owner/Officer Misconduct	4,178	36,856	0.34		
Number of Advisers	4,178	36,856	177	1,240	10
Firm Misconduct Rate (Advisers Past Misconduct)	4,178	36,856	0.10	0.17	0.03
Firm Misconduct Rate (New Misconduct)	4,178	36,856	0.005	0.03	0.00
Formation Type:					
Corporation	4,178	36,856	0.54		
Limited Liability	4,178	36,856	0.42		
Partnership	4,178	36,856	0.03		
Sole Propietership	4,178	36,856	0.00		
Other	4,178	36,856	0.01		
Form ADV Data:					
Services Retail Clients	405	1,136	0.86		
Regulatory AUM (bn)	405	1,554	7.5	35.9	0.4
Number of Accounts	405	1,554	24,535	1,065	133,446
Compensation/Fee Structure					
Assets Under Management	405	1,554	.94		
Hourly	405	1,554	.50		
Fixed Fee	405	1,554	.66		
Commision	405	1,554	.47		
Performance	405	1,554	.09		
Other Data Sources:					
No. Social Network Links	1,696	1,213,820	56,080	142,951	859
Total Assets (bn)	101	1,325,101	91	137	37
Total Revenue (mm)	100	1,316,619	1,192	1,479	464
Avg. Annual Payout	99	1,276,053	230,809	138,832	202,403

Note: Table 2a displays the ten largest firms in terms of the number of advisers as of May 2015. We calculate firm size using our BrokerCheck data set where firms are defined as per the firm's corresponding firm Central Registration Depository (CRD) number. Table 2b displays summary statistics of firms over the period 2005-2015. Observations reported in Tables 2a and 2b (BrokerCheck and Form ADV Data) are firm by year. Observations for Other Data Sources in Table 2b are adviser by year. We report the standard deviation and median for the non-dummy variables. The top portion of table 2b displays the observable firm characteristics in the BrokerCheck database. We only observe firm characteristics in the BrokerCheck database for the 4,178 currently active (as of May 2015) advisory firms. For the BrokerCheck variables we only observe time series variation within firms over the period 2005-2015 for the variables Firm Misconduct Rate and the Number of Advisers; all other BrokerCheck variables are as of May 2015. The Form ADV data comes from the SEC and contains information on a subset of Investment Advisory firms that were required to file a Form ADV with the SEC over the period 2011-2014. We supplement our dataset with social network and survey data. No. Social Network Links measures the number of individuals who follow a firm on a popular social media website as of May 2015. Our data also includes survey data covering the asset, revenue and average adviser payout/salary data for a small subset of firms over the period 2006-2014.

Table 3: Financial Adviser Disclosures and Misconduct

Disclosure	Disclosure/Misconduct	
	Current	Current and Past
Misconduct Related Disclosures:		
Customer Dispute - Settled	0.317%	3.71%
Employment Separation After Allegations	0.183%	0.98%
Regulatory - Final	0.096%	1.23%
Criminal - Final Disposition	0.025%	2.05%
Customer Dispute - Award/Judgment	0.017%	0.57%
Civil - Final	0.003%	0.03%
Any Misconduct Related Disclosure	0.603%	7.28%
Other Disclosures:		
Financial - Final	0.348%	2.10%
Customer Dispute - Denied	0.311%	3.20%
Judgment/Lien	0.215%	1.00%
Customer Dispute - Closed-No Action	0.072%	0.96%
Financial - Pending	0.058%	0.20%
Customer Dispute - Pending	0.057%	0.28%
Customer Dispute - Withdrawn	0.016%	0.17%
Criminal - Pending Charge	0.009%	0.02%
Investigation	0.009%	0.03%
Regulatory - Pending	0.004%	0.01%
Civil - Pending	0.004%	0.01%
Customer Dispute - Final	0.002%	0.02%
Customer Dispute - Dismissed	0.001%	0.01%
Civil Bond	0.001%	0.02%
Regulatory - On Appeal	0.001%	0.00%
Criminal - On Appeal	0.000%	0.00%
Civil - On Appeal	0.000%	0.00%
Any Disclosure	**1.620%**	**12.73%**

Note: Table 3 displays the incidence of disclosures/misconduct among financial advisers over the period 2005-2015. We classify the six categories listed at the top of the table as being indicative of adviser misconduct. Observations are year by financial adviser. The column "Current" displays the share of observations (year by adviser) in which the adviser received one or more of a given type of disclosure that particular year. In other words, on average 0.603% of advisers received at least one disclosure that we classify as misconduct in a given year. The column "Current and Past" displays the share of observations (year by adviser) in which the adviser was disciplined for misconduct in that particular year and/or previously. In other words, on average 7.28% of advisers in a given year are either disciplined for misconduct or have been disciplined for misconduct in the past. Our data set consists of 1.2mm advisers and 7.9mm adviser by year observations over the period 2005-2015.

Table 4: Sources of Misconduct and Settlements/Damages Granted

(a) Reasons for Complaint

Reasons for Complaint	Disclosure Type	
	Misconduct	Other Type of Disc.
Unsuitable	21.29%	31.12%
Misrepresentation	17.69%	25.57%
Unauthorized Activity	15.07%	10.55%
Omission of Key Facts	11.61%	7.72%
Fee/Commission Related	8.67%	7.41%
Fraud	7.89%	4.17%
Fiduciary Duty	6.48%	4.45%
Negligence	5.83%	4.50%
Risky Investments	3.72%	6.25%
Churning/ Excessive Trading	2.58%	2.65%
Other	42.52%	31.47%

(b) Products

Product	Disclosure Type	
	Misconduct	Other Type of Disc.
Insurance	13.81%	15.18%
Annuity	8.55%	18.61%
Stocks	6.04%	6.33%
Mutual Funds	4.60%	5.85%
Bonds	1.93%	4.46%
Options	1.20%	1.22%
Other/Not Listed	69.90%	54.99%

(c) Settlements/Damages

Variable	Obs	Mean	Std. Dev.	Median
Misconduct Related Disclosures:				
Settlements/Damages Granted	35,406	551,471	9,300,282	40,000
Settlements/Damages Requested	28,046	1,520,231	61,601,420	100,000
Other Disclosures:				
Settlements/Damages Granted	751	6,142,410	50,738,600	45,478
Settlements/Damages Requested	751	739,753	18,655,940	32,199

Note: For a large subset of the misconduct/disclosures in the BrokerCheck database we observe additional information on the allegations/ reason for the complaint. We observe allegations for 91.89% of the misconduct related disclosures and 33.42% of the other types of disclosures. Table 4a displays the most frequently reported allegations corresponding to the disclosures that occurred over the period 2005-2015. The allegation categories are not mutually exclusive. The "Other" category includes all other allegations/classifications that were reported with a frequency of less than 2%. The largest subcategory of the "Other" allegations category is that the adviser sold an "Unregistered Security" which was listed in 1.90% and 0.49% of misconduct related and other types of disclosures. A subset of the allegations also report the type financial product pertaining to the incidence of misconduct. Table 4b displays the most frequently reported financial products in the allegations. Over half of the allegations do not list a specific financial product. Table 4c displays the settlements/damages that were granted and requested over the period 2005-2015. In the BrokerCheck database we observe the settlements/damages details for 45.80% of misconduct related disclosures and 0.55% of the other types of disclosures.

Table 5: Adviser Misconduct: Repeat Offenders

	(1)	(2)	(3)
Prior Misconduct	0.0240***	0.0227***	0.0190***
	(0.001000)	(0.000959)	(0.000735)
Experience		0.000775***	0.00121***
		(1.66e-04)	(1.22e-04)
Exams and Qual. (Series):			
Inv. Adviser Exam (65/66)		0.00314***	0.00219***
		(0.000309)	(0.000240)
Sec. Agent St. Law (63)		0.00171***	0.00131***
		(0.000207)	(0.000177)
Gen. Sec. Rep. (7)		0.000323	0.000447*
		(0.000329)	(0.000242)
Inv. Co. Prod. Rep. (6)		4.31e-05	0.000278
		(0.000287)	(0.000285)
Gen. Sec. Principal (24)		0.000200	5.41e-05
		(0.000304)	(0.000204)
No. Other Qual.		-0.00259**	-0.00292***
		(0.00106)	(7.45e-04)
Year×Firm×County F.E.			X
Observations	7,946,680	7,946,680	7,689,495
R-squared	0.006	0.007	0.093

Note: Table 5 displays the regression results for a linear probability model. The dependent variable is a dummy variable indicating whether or not the adviser was formally disciplined for misconduct in year t. The key independent variable of interest is Previous Misconduct which indicates whether or not the adviser has been disciplined previously for misconduct. The independent variables Experience and No. Other Qual. are measured in tens of years and tens of qualifications. All other independent variables are dummy variables. Observations are at the adviser by year level. The data set contains the universe of financial advisers (1.2mm advisers) over the period 2005-2015 such that there are 7.9mm adviser by year observations. Standard errors are in parenthesis and are clustered by firm. *** p<0.01, ** p<0.05, * p<0.10.

Table 6: Firms with the Highest and Lowest Incidence of Misconduct

(a) % of Advisers who have been Disciplined for Misconduct

Rank	Firm	Firm CRD#	Misconduct Rate	# Advisers
1	OPPENHEIMER & CO. INC.	249	19.60%	2,275
2	FIRST ALLIED SECURITIES, INC.	32444	17.72%	1,112
3	WELLS FARGO ADVISORS FINANCIAL NETWORK, LLC	11025	15.30%	1,797
4	UBS FINANCIAL SERVICES INC.	8174	15.14%	12,175
5	CETERA ADVISORS LLC	10299	14.39%	1,432
6	SECURITIES AMERICA, INC.	10205	14.30%	2,546
7	NATIONAL PLANNING CORPORATION	29604	14.03%	1,760
8	RAYMOND JAMES & ASSOCIATES, INC.	705	13.74%	5,495
9	STIFEL, NICOLAUS & COMPANY, INCORPORATED	793	13.27%	4,008
10	JANNEY MONTGOMERY SCOTT LLC	463	13.27%	1,394

(b) % of Advisers who have been Disciplined for Misconduct

Rank	Firm	Firm CRD#	Misconduct Rate	# Advisers
1	MORGAN STANLEY & CO. LLC	8209	0.79%	3,807
2	GOLDMAN, SACHS & CO.	361	0.88%	7,380
3	BNP PARIBAS SECURITIES CORP.	15794	1.17%	1,109
4	SUNTRUST ROBINSON HUMPHREY, INC.	6271	1.25%	1,040
5	BLACKROCK INVESTMENTS, LLC	38642	1.39%	1,442
6	UBS SECURITIES LLC	7654	1.51%	1,785
7	JEFFERIES LLC	2347	1.67%	1,676
8	PRUDENTIAL INVESTMENT MANAGEMENT SERVICES LLC	18353	1.70%	1,234
9	WELLS FARGO SECURITIES, LLC	126292	1.70%	2,876
10	PERSHING LLC	7560	1.72%	1,049

Note: Tables 6a and 6b display the firms in the U.S. with highest and lowest misconduct rates as of May 2015. We calculate the firm misconduct rate using our BrokerCheck data set where firms are defined as per the firm's corresponding firm Central Registration Depository (CRD) number. The misconduct rate is defined as the percentage of advisers working for a firm that have been disciplined for misconduct in the past. In other words, as of May 2015 19.60% of advisers working for Oppenheimer & Co. had received a misconduct related disclosure. We restrict the set of firms to those with at least 1,000 advisers.

Table 7: Firm Misconduct and its Characteristics

	(1)	(2)	(3)	(4)
$Misconduct\ Rate_{t-1}$	0.173***	0.147***	0.142***	0.134***
	(0.0180)	(0.0179)	(0.0177)	(0.0205)
Owner/Officer Misconduct		0.00358***	0.00347***	0.00324***
		(0.000364)	(0.000360)	(0.000511)
No. advisers (millions)		0.0148	0.0157	0.819**
		(0.0282)	(0.0284)	(0.0383)
Investment Advisory Firm		-0.000201	-0.000364	-0.000571
		(0.000414)	(0.000395)	(0.000608)
Affiliated w/ Fin. Inst.		-0.000918**	-0.000899**	-0.000974*
		(0.000387)	(0.000380)	(0.000507)
Firm Age		-3.31e-04***	-2.42e-04**	-3.76e-04
		(1.09e-04)	(1.13e-04)	(2.39e-04)
ln(Social Network Links)				-0.000235***
				(8.41e-05)
Other Firm Controls		X	X	X
Year F.E.			X	X
State F.E.			X	X
	34,415	32,780	32,780	13,891
R-squared	0.035	0.059	0.069	0.078

Note: Table 7 displays the regression results corresponding to the regression of the firm misconduct rate on a set of firm covariates. The firm misconduct rate is defined as the percentage of advisers currently working for a firm that were disciplined for misconduct in year t. The Owner/Office misconduct variable is a dummy variable indicating that at least one of the firm's owners and/or officers has been disciplined for misconduct in the past. Firm Age is measured in tens of years. We also control for the firm's formation type (corporation, limited liability, etc.) as well as whether or not it has a referral arrangement with other advisory firms. Observations are at the firm by year level. The data consists of an unbalanced panel of the universe of 4,178 currently active financial advisory firms over the period 2005-2015. Our data set does not include currently inactive firms that were active prior to May 2015. Firms are defined based on the firm name and corresponding CRD identification number. Each observation is weighted by the square root of the number of advisers in the firm. Standard errors are in parenthesis and are clustered by firm. *** p<0.01, ** p<0.05, * p<0.10.

Table 8: Consequences of Misconduct

(a) Industry and Firm Discipline

	No Misconduct	Misconduct
Remain with the Firm	81.29%	51.99%
Leave the Firm	18.71%	48.01%
Leave the Industry	8.92%	26.96%
Join a Different Firm (within 1 year)	9.79%	21.05%

(b) Firm Level Consequences

	(1)	(2)	(3))
Misconduct	0.293***	0.308***	0.244***
	(0.0169)	(0.0162)	(0.0182)
Adviser Controls		X	X
Year×Firm×County F.E.			X
Observations	7,278,974	7,278,974	7,041,116
R-squared	0.004	0.011	0.326

(c) Industry Level Consequences

	Industry Separation			New Employment		
	(1)	(2)	(3)	(4)	(5)	(6)
Misconduct	0.180***	0.200***	0.178***	-0.0847**	-0.128***	-0.0953***
	(0.0198)	(0.0185)	(0.0202)	(0.0248)	(0.0153)	(0.0111)
Adviser Controls		X	X		X	X
Year×Firm×County F.E.			X			X
Observations	7,278,974	7,278,974	7,041,116	1,375,641	1,375,641	1,265,813
R-squared	0.003	0.023	0.152	0.000	0.125	0.374

Note: Table 8a displays the average annual job turnover among financial advisers over the period 2005-2015. The table shows, on average, the percentage of advisers that remain with their firm, leave the industry (for at least one year) or join a new firm (within a year). The job transitions are broken down by the whether or not the adviser was disciplined for misconduct in the previous year.
Tables 8b and 8c display the regression results corresponding to linear probability models. The dependent variable in Table 8b is a dummy variable indicating whether or not a financial adviser left his firm (either leaving the industry or switching firms). The dependent variable in columns (1)-(3) of Table 8c is a dummy variable indicating whether or not a financial adviser left the industry for at least one year. The dependent variable in columns (4)-(6) of Table 8c is a dummy variable indicating whether or not a financial adviser joined a new firm within one year. In columns (4)-(6) of Table 8c we restrict the sample to those advisers who left their firm in a given year. In Tables 8b and 8c the key independent variable of interest is Misconduct which indicates whether or not an adviser was disciplined for misconduct in the previous year. Other adviser controls include the advisers experience, tests (series 6, 7, 63, 24 and investment adviser exam), and number of other qualifications. Observations are at the financial adviser by year level. The data set contains the universe of active financial advisers (1.2mm advisers) over the period 2005-2015. Standard errors are in parenthesis and are clustered by firm. *** p<0.01, ** p<0.05, * p<0.10.

Table 9: Severity of Misconduct

(a) Firm Level Consequences

	(1)	(2)	(3)
ln(Settlement)	0.00592	0.00990**	0.00886***
	(0.00477)	(0.00470)	(0.00170)
Other Adviser Controls		X	X
Year F.E.			X
County F.E.			X
Firm F.E.			X
	25,083	25,083	24,791
R-squared	0.001	0.017	0.087

(b) Industry Level Consequences

	Industry Separation			New Employment		
	(1)	(2)	(3)	(4)	(5)	(6)
ln(Settlement)	0.00761***	0.0109***	0.0131***	-0.018**	-0.024***	-0.0286***
	(0.00212)	(0.00204)	(0.00116)	(0.00747)	(0.00669)	(0.00330)
Other Adviser Controls	X	X	X	X	X	X
Year F.E.			X			X
County F.E.			X			X
Firm F.E.			X			X
	25,083	25,083	24,791	6,874	6,874	6,771
R-squared	0.002	0.021	0.076	0.005	0.0765	0.157

Note: Tables 9a and 9b display the regression results for linear probability models. The dependent variable in Table 9a is a dummy variable indicating whether or not a financial adviser left his firm (either leaving the industry or switching firms). The dependent variable in columns (1)-(3) of Table 9b is a dummy variable indicating whether or not a financial adviser left the industry for at least one year. The dependent variable in columns (4)-(6) of Table 9b is a dummy variable indicating whether or not a financial adviser joined a new firm within one year. In columns (4)-(6) of Table 9b we restrict the sample to those advisers who left their firm in a given year. The key independent variable of interest is the log settlement/damage amount paid out by an adviser in the previous year. We observe the settlements/damages details for 45.80% of misconduct related disclosures. Other adviser controls include the advisers experience, tests (series 6, 7, 63, 24 and investment adviser exam), and number of other qualifications. Observations are at the financial adviser by year level over the period 2005-2015. We restrict the data set to only those observations in which the adviser was disciplined for misconduct and paid out a settlement/damages. Standard errors are in parenthesis and are clustered by firm. *** p<0.01, ** p<0.05, * p<0.10.

Table 10: Unemployment Duration

	(1)	(2)	(3)	(4)
Misconduct	0.828***	0.832***	1.025***	1.026***
	(0.00642)	(0.00645)	(0.00795)	(0.00796)
Other Adviser Controls	X	X	X	X
Year F.E.		X		X
Complete Unemployment Spells			X	X
Observations	1,357,046	1,357,046	758,870	758,870

Note: Table 10 displays the estimation results corresponding to a Cox proportional hazard model. The dependent variable is the length of an unemployment spell in months. The key independent variable of interest Misconduct is a dummy variable indicating whether or not the adviser was disciplined for misconduct in the year prior to his/her unemployment spell. Other adviser controls include the adviser's experience, test's (series 6, 7, 63, 24 and investment adviser exam), and number of other qualifications. The coefficients are reported in terms of proportional hazards such that a coefficient less than one indicates that it takes longer for an adviser to find a new job. Observations are at the financial adviser by unemployment spell level. The data set contains the universe of financial adviser unemployment spells over the period 2005-2015. In columns (3)-(4) we restrict the data set to include only those observations where we observe a complete unemployment spell - i.e. the adviser found a job. Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.10.

Table 11: What Types of Firms do Advisers Switch To?

	Avg. Payout	No. Social Links	Misc. Rate	Firm Size	Assets ($bn)	Rev. ($mm)
Misconduct	-14,690***	-12,477***	0.00532***	-1,898***	-36.76***	-391***
	(3,567)	(3,361)	(0.000577)	(230.2)	(4.82)	(41)
Orig Firm x Year F.E.	X	X	X	X	X	X
Observations	69,051	32,588	456,949	456,949	75,393	75,088
R-squared	0.002	0.002	0.007	0.002	0.000	0.003

Note: Table 11 displays the characteristics of new firms joined by advisers who switched firms as a function of whether or not the adviser was disciplined for misconduct in the year prior to the job transition. Specifically we regress the new firm characteristic (size, misconduct rate, etc.) on a dummy variable Misconduct which indicates whether or not the adviser was disciplined for misconduct in the year prior to his/her job transition. Observations are adviser by job transition where the adviser found a job within a year. Each specification also includes a year by original/previous firm fixed effect. Conceptually this allows us to compare the job outcomes of advisers that were working for the same firm who *were* and *were not* disciplined for misconduct prior to switching jobs. We restrict the data set to include only those observations where we observe advisers leaving a given firm in a given year where both advisers who were and were not disciplined for misconduct left. A negative coefficient in the Firm Size column indicates that advisers who were disciplined for misconduct in the year prior to his/her job transition move to smaller firms relative to advisers who were not disciplined. The dependent variable misconduct rate is defined as the percentage of advisers working for a firm that were disciplined for misconduct in year $t-1$ (the year prior to the new adviser joining the firm). We only observe Asset, Revenue, Average Payout/Salary, and Social Network Link data for a small subset of firms. The Asset, Revenue, Average Payout/Salary and Social Network Link data is all measured as of 2015. Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.10.

Table 12: Firm Dissolutions

(a) What Types of Firms do Advisers Switch To?

	Firm Size	Misc. Rate
Misconduct	0.00347***	-827.485*
	(0.0124)	(452.523)
Original Firm x Year F.E.	X	X
Observations	70,757	70,757
R-squared	0.007	0.001

(b) Firm Level Consequences

	(1)	(2)	(3)
Misconduct	0.206***	0.230***	0.159***
	(0.0354)	(0.0320)	(0.00938)
Adviser Controls		X	X
Year×Firm×County F.E.			X
Observations	124,696	124,696	122,665
R-squared	0.003	0.055	0.039

Note: Table 12a display the characteristics of new firms joined by advisers who switched firms as a function of whether or not the adviser was disciplined for misconduct in the year prior to the job transition. Specifically we regress the new firm characteristic (size, misconduct rate, etc.) on a dummy variable Misconduct which indicates whether or not the adviser was disciplined for misconduct in the year prior to his/her job transition. Observations are adviser by job transition where the adviser found a job within a year. Each specification also includes a year by original/previous firm fixed effect. We restrict the data set to include only those observations where we observe advisers leaving a given firm in a given year where both advisers who were and were not disciplined for misconduct left. The dependent variable misconduct rate is defined as the percentage of advisers working for a firm that were disciplined for misconduct in year $t-1$ (the year prior to the new adviser joining the firm). We restrict the data set to only those job transitions that were the result of a firm dissolution.
Table 12b displays the regression results corresponding to a linear probability model. The dependent variable is a dummy variable indicating whether or not the adviser left the industry for at least one year. Observations are year by adviser. We restrict our data set to those advisers and years where the advisers' previous firm went out of business in the prior year. Hence the data set only includes those adviser/year observations in which the adviser either switched firms within a year or left the industry for at least one year. The key independent variable of interest is a dummy variable indicating whether or not the adviser was disciplined for misconduct in the year prior to the job transition. Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.10.

Table 13: Firm Differences in Tolerance for Misconduct

(a) Job Separations

	(1)	(2)	(3)
Misconduct	0.312***	0.331***	0.274***
	(0.0189)	(0.0174)	(0.184)
Firm Misconduct	2.786***	3.057***	
	(0.406)	(0.372)	
Firm Misconduct × Misconduct	-2.843***	-3.104***	-1.312***
	(0.408)	(0.368)	(0.111)
Adviser Controls	X	X	X
Year×Firm×County F.E.			X
Observations	7,278,974	7,278,974	7,241,162
R-squared	0.009	0.017	0.345

(b) Firm Hiring

	(1)	(2)	(3)
$Misconduct\ Rate_{t-1}$	0.379***	0.373***	0.364***
	(0.0565)	(0.0563)	(0.0555)
Owner/Officer Misconduct	0.00761***	0.00762***	0.00708***
	(0.00132)	(0.00132)	(0.00131)
No. advisers (millons)	-0.372***	-0.373***	-0.321**
	(0.132)	(0.135)	(0.135)
Investment Advisory Firm	0.000466	0.000805	0.000664
	(0.00154)	(0.00155)	(0.00159)
Affiliated w/ Fin. Inst.	-0.00943***	-0.00935***	-0.00776***
	(0.00167)	(0.00167)	(0.00169)
Firm Age	-1.89e-04	-4.63e-04	-4.17e-04
	(3.53e-04)	(3.62e-04)	(3.58e-04)
Year F.E.		X	X
State F.E.			X
Observations	17,847	17,847	17,847
R-squared	0.044	0.045	0.052

Note: Table 13a displays the regression results corresponding to a linear probability model. The dependent variable is a dummy variable indicating whether or not a financial adviser left his firm (either leaving the industry or switching firms). The independent variable misconduct indicates whether or not an adviser was disciplined for misconduct in the previous year. We also control for the firm misconduct rate which measures the percentage of advisers working for a firm who were disciplined in a given year. The key independent variable of interest is the interaction between misconduct and the firm misconduct rate. Other adviser controls include the advisers experience, tests (series 6, 7, 63, 24 and investment adviser exam), and number of other qualifications. Observations are at the financial adviser by year level. The data set contains the universe of active financial advisers (1.2mm advisers) over the period 2005-2015. Standard errors are in parenthesis and are clustered by firm.
Table 13b displays the estimation results corresponding to a firm's hiring patterns. The dependent variable is the percentage of new hires made by a firm who were disciplined for misconduct in the previous year. The key independent variable is the firm misconduct rate which is defined as the percentage of advisers currently working for a firm that were disciplined for misconduct in year t. Firm age is measured in tens of years. We also control for the firm's formation type (corporation, limited liability, etc.) as well as whether or not it has a referral arrangement with other advisory firms. Observations are at the firm by year level. The data consists of an unbalanced panel of the universe of 4,178 currently active advisory firms over the period 2005-2015. Our data set does not include currently inactive firms that were active prior to May 2015. Firms are defined based on the firm name and corresponding CRD identification number. Each observation is weighted by the square root of the number of advisers in the firm. Standard errors are in parenthesis and are clustered by firm. *** p<0.01, ** p<0.05, * p<0.10.

Table 14: Consumer Sophistication and Misconduct

	Misconduct Rate			
	Current and Past Misconduct		Current Misconduct	
	(1)	(2)	(3)	(4)
Retail Investors	0.0332***	0.0340***	0.00248**	0.00243**
	(0.0107)	(0.0108)	(0.000959)	(0.00100)
Number of Accts (millions)	-0.00594	0.0547***	-0.000399	-0.000423
	(0.0137)	(0.0204)	(0.000842)	(0.000237)
Compensation Structure:				
Assets Under Management	0.0203*	0.0150	0.00210*	0.00216**
	(0.0119)	(0.0105)	(0.00108)	(0.00109)
Hourly	0.0348***	0.0323***	0.00207***	0.00226***
	(0.00930)	(0.00864)	(0.000713)	(0.000711)
Fixed Fee	-0.0142	-0.0121	-0.000735	-0.000540
	(0.01000)	(0.00988)	(0.00109)	(0.00117)
Commission	0.0284***	0.0229***	0.000429	0.000275
	(0.00765)	(0.00788)	(0.000829)	(0.000800)
Performance	-0.0182	-0.00351	-0.000842	-0.000243
	(0.0113)	(0.0128)	(0.00128)	(0.00110)
Firm Controls		X		X
Year F.E.		X		X
State F.E.		X		X
Observations	1,136	1,125	1,136	1,125
R-squared	0.179	0.319	0.027	0.097

Note: Table 14 displays the regression results corresponding to the regression of the firm misconduct rate on a set of firm covariates. In columns (1) and (2) we measure the firm misconduct rate as the percentage of advisers currently working for a firm that have been disciplined at or prior to time t. In columns (3) and (4) we measure the firm misconduct rate as the percentage of advisers currently working for a firm that have been disciplined for misconduct in year t. Observations are at the firm by year level over the period 2011-2014. Our data set contains an unbalanced panel of 435 investment advisory firms. Firm controls include the firm size (no. advisers), number of states the firm operates in and the age of the firm. Each observation is weighted by the square root of the number of advisers in the firm. Standard errors are in parenthesis and are clustered by firm. *** p<0.01, ** p<0.05, * p<0.10.

Table 15: Counties with Highest and Lowest Rates of Misconduct

(a) % of advisers with Misconduct Records

Rank	County	Misc. Rate	# Advisers
1	Madison, NY	32.06%	131
2	Indian River, FL	19.15%	282
3	Guaynabo Municipio, PR	19.05%	126
4	Monterey, CA	18.39%	397
5	Martin, FL	18.38%	357
6	Palm Beach, FL	18.11%	5,278
7	Richmond, NY	17.66%	436
8	Suffolk, NY	17.28%	4,136
9	Bay, FL	16.98%	106
10	Lee, FL	16.76%	853

(b) % of advisers with Misconduct Records

Rank	County	Misc. Rate	# Advisers
1	Franklin, PA	2.63%	114
2	Saline, KS	2.68%	112
3	Cerro Gordo, IA	2.68%	112
4	Kenton, KY	2.86%	1,991
5	Washington, VT	3.05%	197
6	Bronx, NY	3.10%	226
7	Rutherford, TN	3.10%	161
8	Stearns, MN	3.26%	491
9	Ottawa, MI	3.52%	312
10	Boone, MO	3.78%	159

(c) Where Does Misconduct Occur?

	Misconduct Rate			
	Current and Past Misconduct		Current Misconduct	
	(1)	(2)	(3)	(4)
ln(pop)	-0.000548	-0.000865	-3.84e-05	0.000107
	(0.00199)	(0.00168)	(0.000248)	(0.000226)
ln(inc)	0.0412***	0.0431***	0.00275*	0.00627***
	(0.0100)	(0.0140)	(0.00152)	(0.00157)
Pct Rural	-0.0458***	-0.0340**	-0.00529***	-0.00482**
	(0.0136)	(0.0137)	(0.00180)	(0.00199)
Pct College	-0.0817**	-0.0774**	-0.00898***	-0.0126***
	(0.0333)	(0.0328)	(0.00320)	(0.00328)
Pct 65 or Older	0.296***	0.271***	0.0260***	0.0242***
	(0.0506)	(0.0486)	(0.00604)	(0.00579)
Labor Force Part.	-0.165***	-0.0525	-0.0216***	-0.0168**
	(0.0453)	(0.0470)	(0.00620)	(0.00710)
Year F.E.		X		X
State F.E.		X		X
Observations	2,607	2,607	2,607	2,607
R-squared	0.214	0.393	0.065	0.172

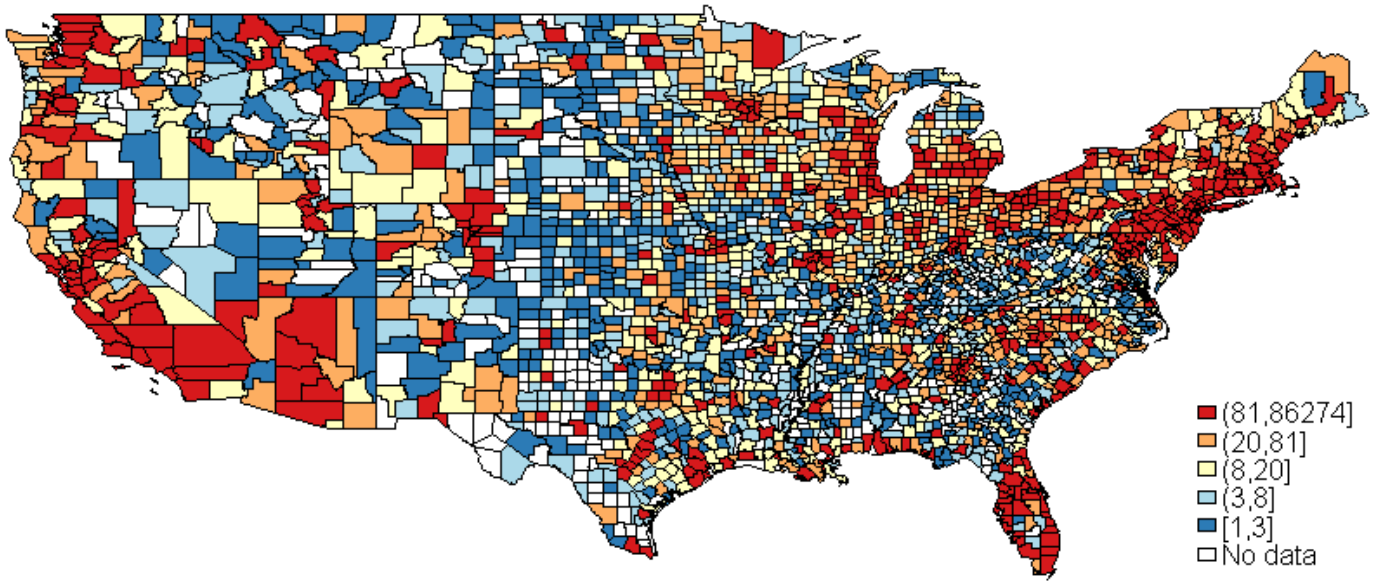
Note: Table 15a panels (a) and (b) display the counties in the U.S. with highest and lowest misconduct rates as of May 2015. The misconduct rate is defined as the percentage of financial advisers in a county that have ever been disciplined for misconduct. We restrict the set of counties to those with at least 100 advisers.
Table 15c displays the regression results corresponding to the regression of the county misconduct rate on a set of county covariates. Observations are at the county by year level over the period 2010-2013. In columns (1) and (2) we measure the misconduct rate as a stock measure as the percentage of advisers currently working in a county who have been disciplined for misconduct in or previously to year t. In columns (3) and (4) we measure misconduct as a flow measure as the percentage of advisers currently working in a county who have been disciplined for misconduct in year t. We restrict the data set to those counties with more than 50 advisers for which demographic data is available from the ACS. In total our sample consists of an unbalanced panel of 667 counties over the period 2010-2013. Each observation is weighted by the square root of the number of advisers in the county. Standard errors are in parenthesis and are clustered by county. *** p<0.01, ** p<0.05, * p<0.10.

Table 16: Robustness: Types of Disclosures

Dep Var.	Misconduct	Job Separation	Unemployment Duration
Misconduct Related Disclosures:			
Employment Separation After Allegations	0.0213***	0.689***	0.749***
	(0.00116)	(0.0154)	(0.00896)
Regulatory - Final	0.0143***	0.0978***	0.421***
	(0.000891)	(0.00963)	(0.00925)
Criminal - Final Disposition	0.00572***	0.0690***	1.092***
	(0.000384)	(0.0984)	(0.0351)
Customer Dispute - Settled	0.0207***	0.0250***	1.163***
	(0.00117)	(0.00431)	(0.0134)
Customer Dispute - Award/Judgment	0.0145***	-0.0134	0.900**
	(0.00150)	(0.0106)	(0.0444)
Civil - Final	0.0183***	0.0954***	0.338***
	(0.00549)	(0.0341)	(0.0424)
Other Disclosures:			
Financial - Final	0.00241***	0.00279	1.537***
	(0.000330)	(0.00646)	(0.0159)
Judgment/Lien	0.0120***	0.00175	1.258***
	(0.00113)	(0.0104)	(0.0188)
Customer Dispute - Denied	0.0135***	0.0109***	1.315***
	(0.000951)	(0.00351)	(0.0156)
Customer Dispute - Closed-No Action	0.0161***	0.0129*	1.254***
	(0.00212)	(0.00686)	(0.0284)
Customer Dispute - Withdrawn	0.0242***	-0.00625	1.320***
	(0.00297)	(0.00989)	(0.0667)
Customer Dispute - Dismissed	0.00357	0.00936	0.958
	(0.00587)	(0.0325)	(0.181)
Customer Dispute - Final	0.0231***	-0.00508	0.615***
	(0.00762)	(0.0248)	(0.106)
Civil Bond	0.00312	-0.00226	1.008
	(0.00364)	(0.0437)	(0.210)
Adviser Controls	X	X	X
Year×Firm×County F.E.	X	X	
Year F.E.			X
Observations	7,689,495	7,041,116	1,357,046
R-squared	0.096	0.329	

Note: Table 16 displays the estimation results corresponding to our three baseline models broken down by the type of disclosure. Column (1) displays the regression results for a linear probability model. The dependent variable is a dummy variable indicating whether or not the adviser was formally disciplined for misconduct in year t. Column (2) displays the corresponding estimates for a linear probability model where the dependent variable is a dummy variable indicating whether or not a financial adviser left his firm. Column (3) corresponds to a Cox proportional hazard model. The dependent variable is the length of an unemployment spell in months. The coefficients in column (3) are reported in terms of proportional hazards such that a coefficient less than one indicates that it takes longer for an adviser to find a new job. Observations are adviser by unemployment spell. In column (1) the disclosure variable indicates whether or not the adviser has previously received a disclosure of that particular type. In columns (2) and (3) the disclosure variable indicates whether or not the adviser received a disclosure of that particular type in the previous year. Other adviser controls include the advisers experience, tests (series 6, 7, 63, 24 and investment adviser exam), and number of other qualifications. Standard errors are clustered by firm. *** p<0.01, ** p<0.05, * p<0.10.

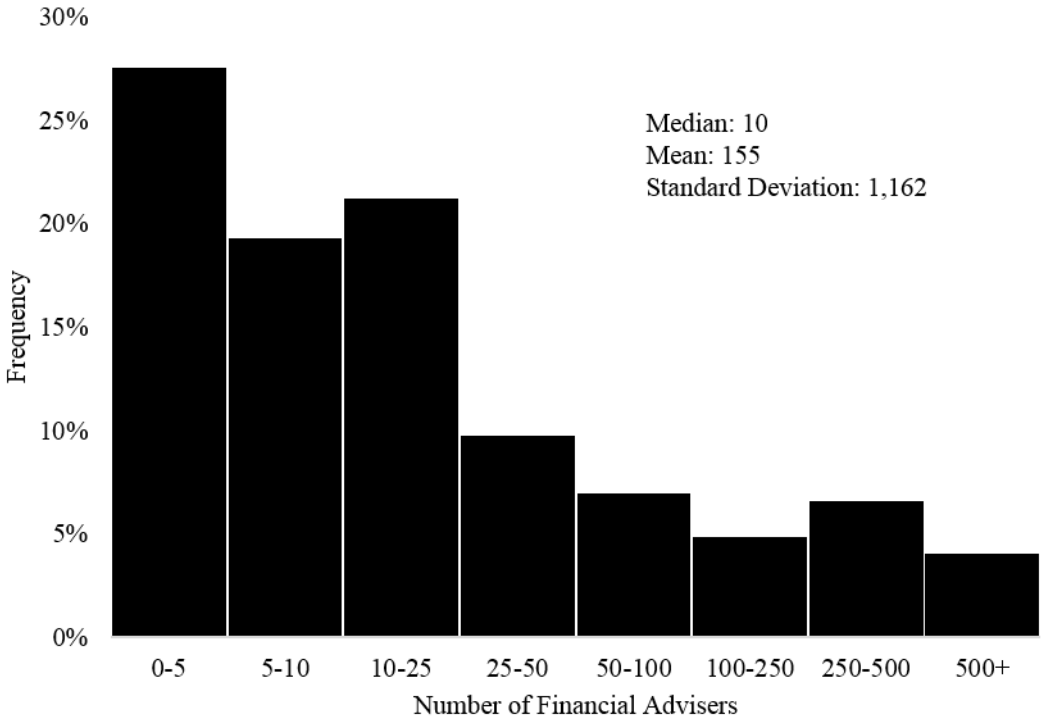
Figure 1: Distribution of Financial Advisers in the US



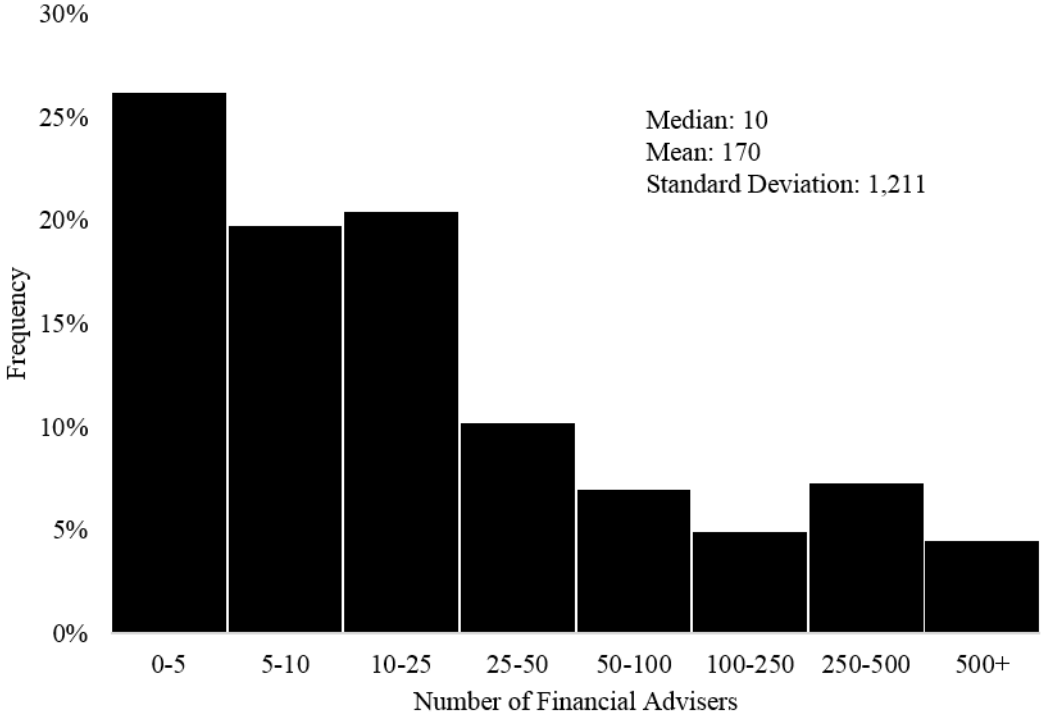
Note: Figure 1 displays the geographic distribution of advisers in terms of advisers per county in the US as of May 2015.

Figure 2: Size Distribution of Financial Advisory Firms

(a) Size Distribution as of 2015

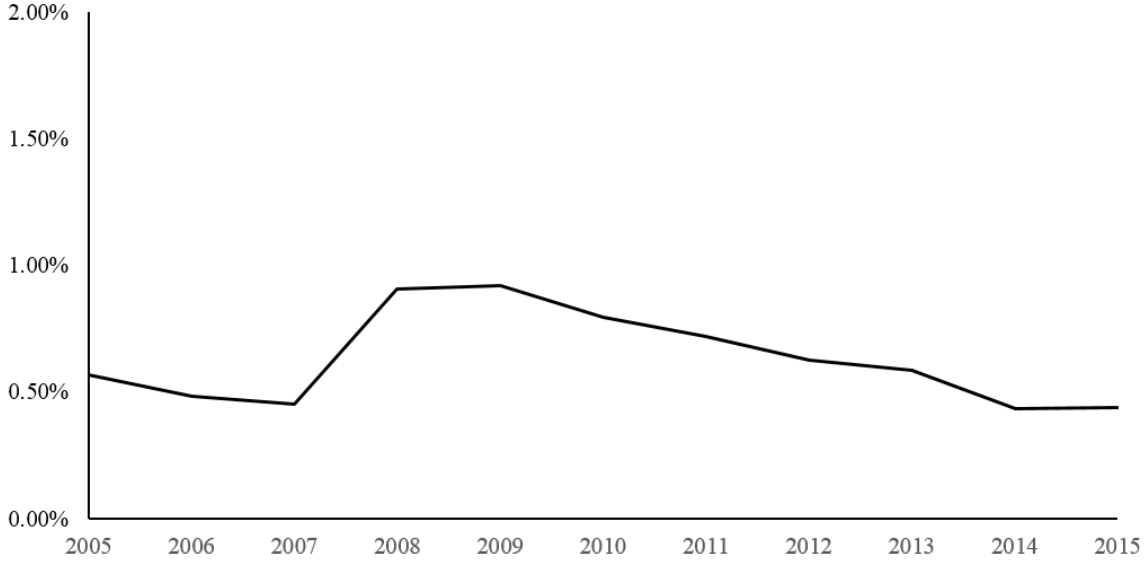


(b) Size Distribution of the Full Sample



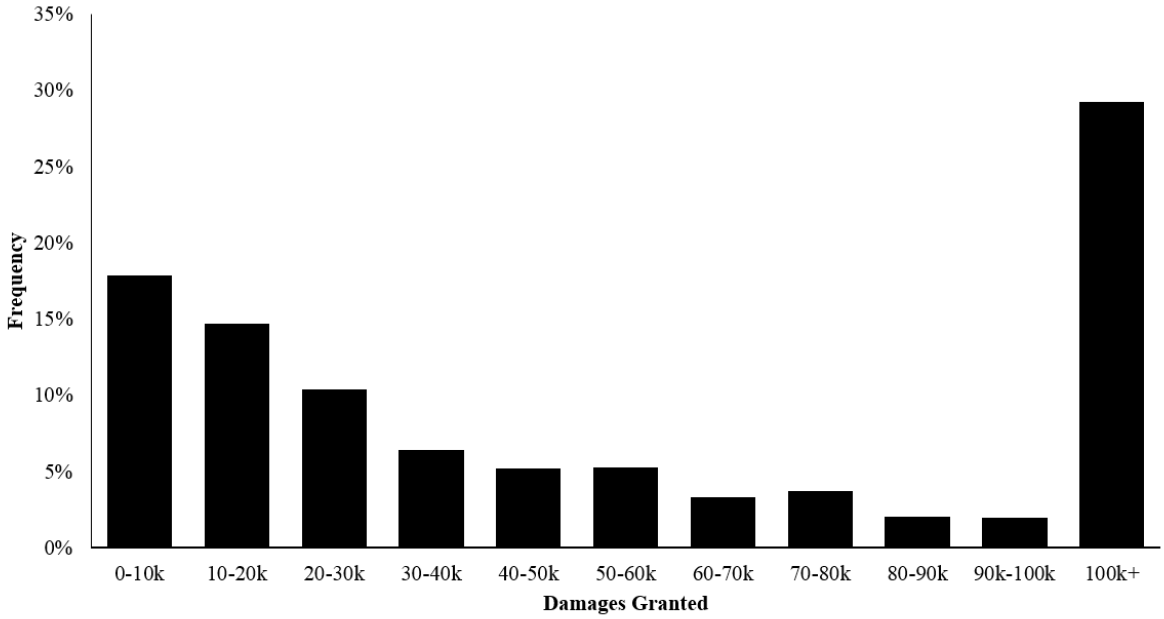
Note: Figure 2a displays the size distribution of US financial advisory firms in terms of the number of registered advisers working at each firm as of May 2015. We calculate firm size using our BrokerCheck data set where firms are defined as per the firm's corresponding firm Central Registration Depository (CRD) number. Our dataset includes the universe of 4,178 active advisory firms currently registered with FINRA. Figure 2b displays the size distribution of our unbalanced panel of 4,178 firms over the period 2005-2015. Observations in Figure 2b are firm by year.

Figure 3: Misconduct over Time



Note: Figure 3 displays the percentage of financial advisers disciplined for misconduct in each year over the period 2005-2015. We define misconduct as when an adviser receives a disclosure classified as: "Customer Dispute - Settled," "Employment Separation After Allegations," "Regulatory - Final," "Criminal - Final Disposition," "Customer Dispute - Award/Judgment," "Civil - Final," "Any Misconduct Related Disclosure." The series is comprised 1.2mm different advisers which make up 7.9mm adviser by year observations.

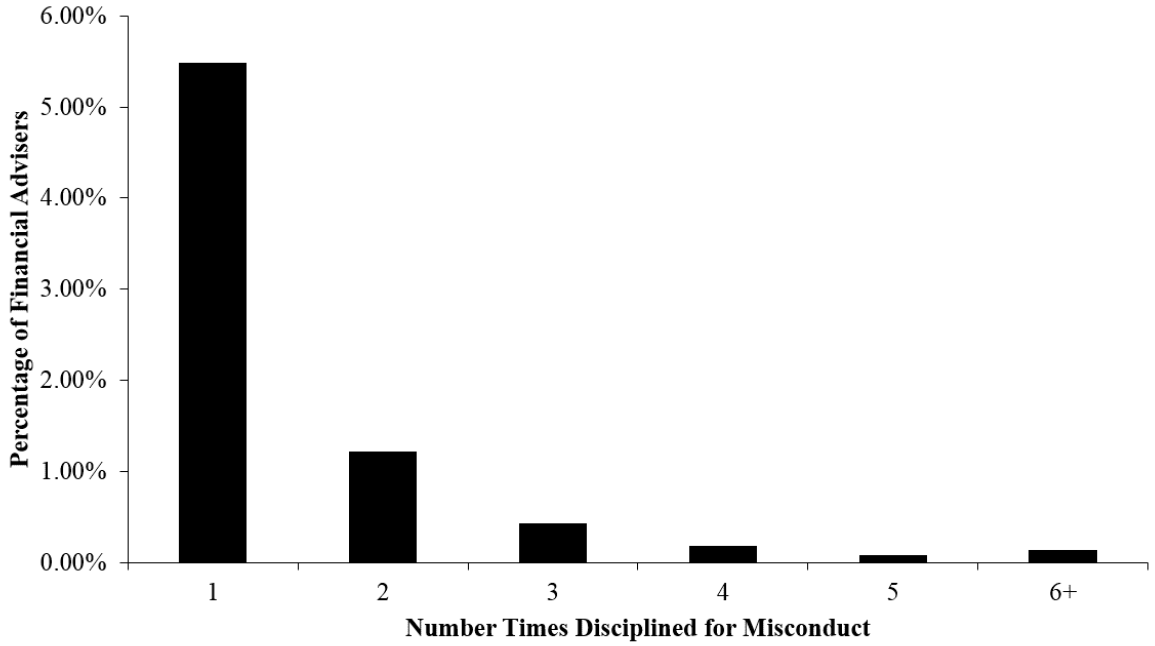
Figure 4: Distribution of Damages



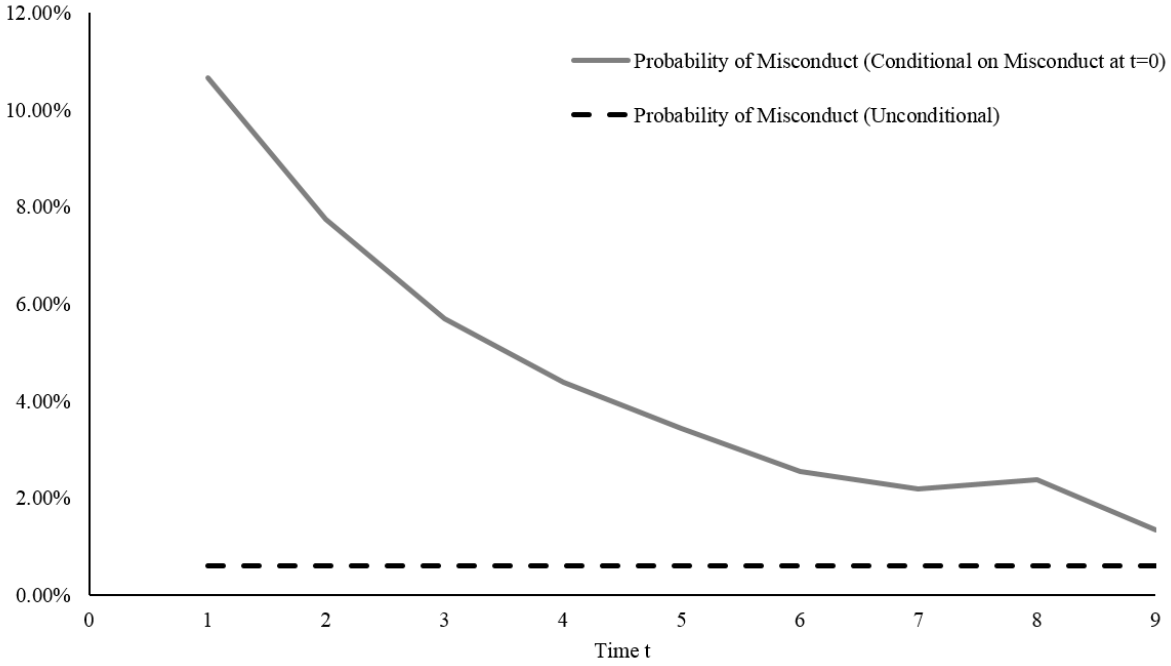
Note: Figure 4 displays the settlements/damages that were granted over the period 2005-2015. In the BrokerCheck database we observe the settlements/damages details for 45.80% of misconduct related disclosures and 0.55% of the other types of disclosures.

Figure 5: Frequency of Misconduct

(a) Distribution of Misconduct



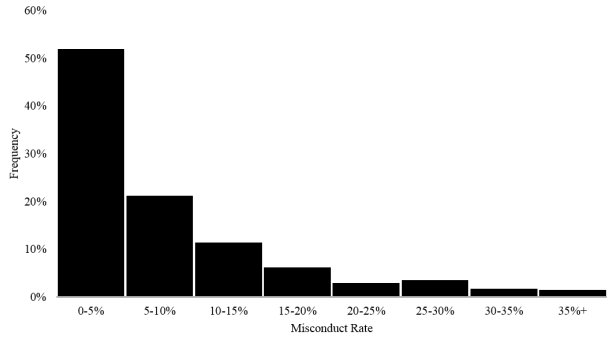
(b) Misconduct: Repeat Offenders



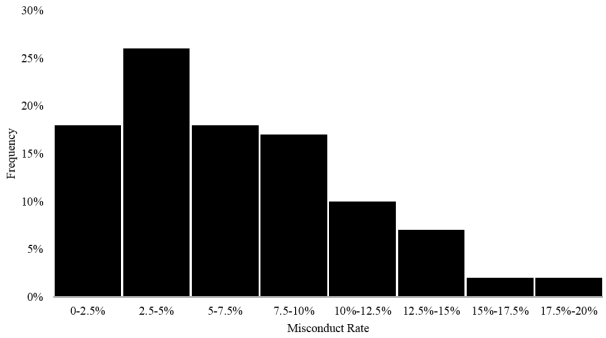
Note: Figure 5a displays the number/percentage of currently registered (as of May 2015) of advisers who have ever been formally disciplined for misconduct in the US and the number of times they have been disciplined. Our sample consists of the universe of 645k currently registered financial advisers.
The black line in Figure 5b displays the conditional probability of being disciplined for misconduct at time t given the adviser was disciplined at time $t = 0$. The gray line displays the unconditional probability an adviser is disciplined for misconduct. The conditional/unconditional probabilities are constructed using our full sample of advisers which consists of 7.9mm adviser by year observations.

Figure 6: Distribution of Misconduct Across Firms

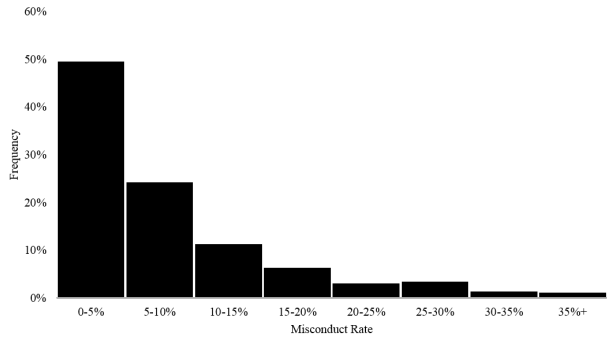
(a) Firms with at Least 100 Employees (as of 2015)



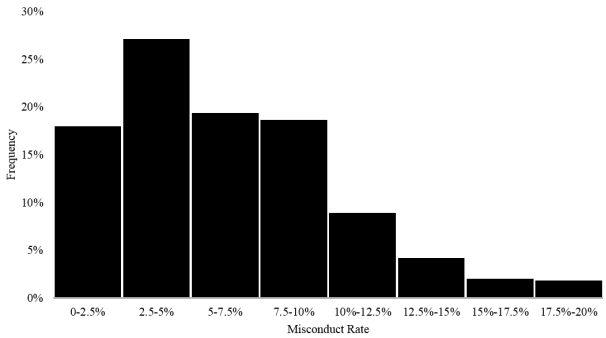
(b) Firms with at Least 1,000 Employees (as of 2015)



(c) Firms with at Least 100 Employees (2005-2015)



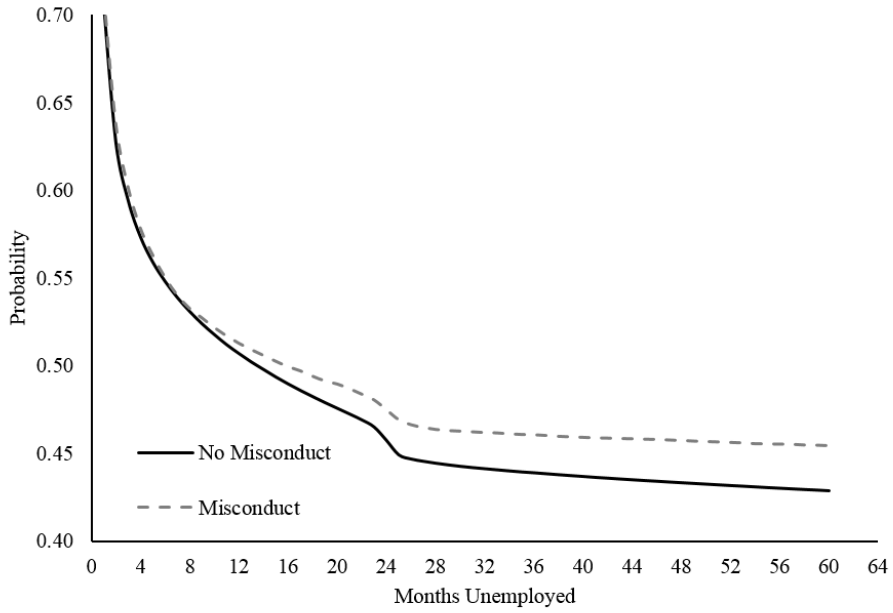
(d) Firms with at Least 1,000 Employees (2005-2015)



Note: Figures 6a and 6b display the distribution of firms in terms of the percentage of advisers working for the firm that have been disciplined for misconduct in the past (the misconduct rate) as of May 2015 for those firms with at least 100 and 1,000 registered advisers. We define a firm's misconduct rate at year t as the percentage of advisers who were disciplined in year t or previously. We calculate firm size and the firm misconduct rate using our BrokerCheck data set where firms are defined as per the firm's corresponding firm Central Registration Depository (CRD) number. Our dataset includes the universe of 4,178 active advisory firms currently registered with FINRA. Figures 6c and 6d displays the distribution of firm misconduct rates of our unbalanced panel of 4,178 firms over the period 2005-2015. Observations in Figures 6c and 6d are firm by year.

Figure 7: Unemployment and Misconduct

(a) Unemployment Survival Function



(b) Unemployment Survival Function - Conditional on Finding a Job

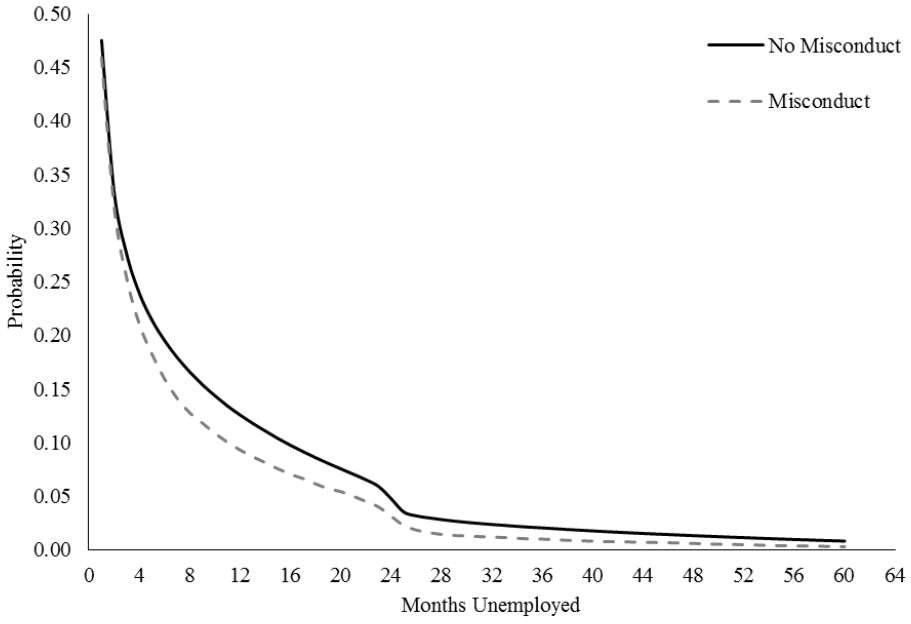
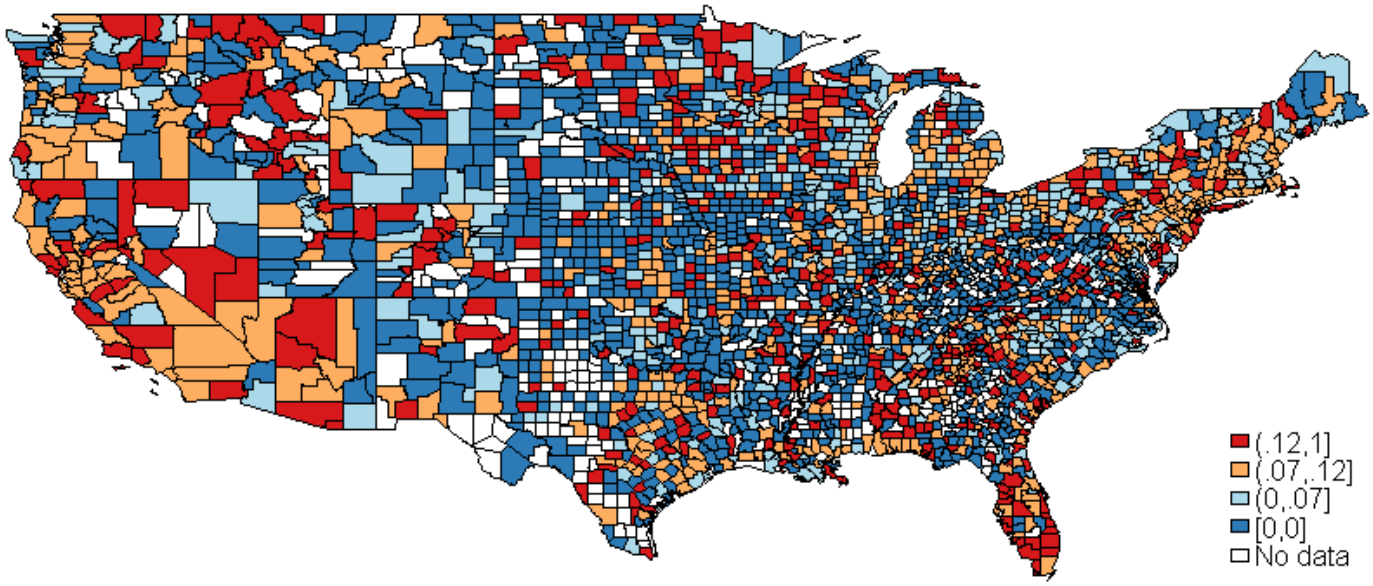


Figure 7a displays the unemployment survival function for all adviser unemployment spells over the period 2005-2015. We observe over 1.3mm adviser unemployment spells over the period 2005-2015. The dashed gray (solid black) line plots unemployment survival function for those adviser who were (were not) disciplined for misconduct in the twelve months prior to the start of their unemployment spell. In Figure we plot the unemployment survival function where we restrict our sample to complete unemployment spells. Of the 1.3m unemployment spells, we observe a complete unemployment spell (the adviser finds a job) for 760k of the spells.

Figure 8: Percentage of Financial Advisers Disciplined for Misconduct in Each County



Note: Figure 8 displays the percentage of advisers who have been previously formally disciplined for misconduct in the US or the *Misconduct_Rate* as of May 2015. Bright red counties are in the highest quintile in terms of the percentage of advisers who have been disciplined for misconduct. Over one in nine financial advisers in the bright red counties have been disciplined for misconduct.

Appendix

A1: Disclosure Definitions[27]

Civil-Final: This type of disclosure event involves (1) an injunction issued by a court in connection with investment-related activity, (2) a finding by a court of a violation of any investment-related statute or regulation, or (3) an action brought by a state or foreign financial regulatory authority that is dismissed by a court pursuant to a settlement agreement.

Civil - Pending: This type of disclosure event involves a pending civil court action that seeks an injunction in connection with any investment-related activity or alleges a violation of any investment-related statute or regulation.

Customer Dispute - Award/Judgment: This type of disclosure event involves a final, consumer-initiated, investment-related arbitration or civil suit containing allegations of sales practice violations against the adviser that resulted in an arbitration award or civil judgment for the customer.

Customer Dispute - Settled: This type of disclosure event involves a consumer-initiated, investment-related complaint, arbitration proceeding or civil suit containing allegations of sale practice violations against the adviser that resulted in a monetary settlement to the customer.

[27] Definitions as per http://brokercheck.finra.org/

Customer Dispute - Closed-No Action/Withdrawn/Dismissed/Denied/Final: This type of disclosure event involves (1) a consumer-initiated, investment-related arbitration or civil suit containing allegations of sales practice violations against the individual adviser that was dismissed, withdrawn, or denied; or (2) a consumer-initiated, investment-related written complaint containing allegations that the adviser engaged in sales practice violations resulting in compensatory damages of at least $5,000, forgery, theft, or misappropriation, or conversion of funds or securities, which was closed without action, withdrawn, or denied.

Customer Dispute - Pending: This type of disclosure event involves (1) a pending consumer-initiated, investment-related arbitration or civil suit that contains allegations of sales practice violations against the adviser; or (2) a pending, consumer-initiated, investment related written complaint containing allegations that the adviser engaged in, sales practice violations resulting in compensatory damages of at least $5,000, forgery, theft, or misappropriation, or conversion of funds or securities.

Employment Separation After Allegations: This type of disclosure event involves a situation where the adviser voluntarily resigned, was discharged, or was permitted to resign after being accused of (1) violating investment-related statutes, regulations, rules or industry standards of conduct; (2) fraud or the wrongful taking of property; or (3) failure to supervise in connection with investment-related statutes, regulations, rules, or industry standards of conduct.

Judgment/Lien: This type of disclosure event involves an unsatisfied and outstanding judgments or liens against the adviser.

Criminal - Final Disposition: This type of disclosure event involves a criminal charge against the adviser that has resulted in a conviction, acquittal, dismissal, or plea. The criminal matter may pertain to any felony or certain misdemeanor offenses, including bribery, perjury, forgery, counterfeiting, extortion, fraud, and wrongful taking of property.

Financial - Final: This type of disclosure event involves a bankruptcy, compromise with one or more creditors, or Securities Investor Protection Corporation liquidation involving the adviser or an organization the adviser controlled that occurred within the last 10 years.

Financial - Pending: This type of disclosure event involves a pending bankruptcy, compromise with one or more creditors, or Securities Investor Protection Corporation liquidation involving the adviser or an organization the adviser controlled that occurred within the last 10 years.

Investigation: This type of disclosure event involves any ongoing formal investigation by an entity such as a grand jury state or federal agency, self-regulatory organization or foreign regulatory authority. Subpoenas, preliminary or routine regulatory inquiries, and general requests by a regulatory entity for information are not considered investigations and therefore are not included in a BrokerCheck report.

Regulatory - Final: This type of disclosure event may involves (1) a final, formal proceeding initiated by a regulatory authority (e.g., a state securities agency, self-regulatory organization, federal regulatory such as the Securities and Exchange Commission, foreign financial regulatory body) for a violation of investment-related rules or regulations; or (2) a revocation or suspension of a adviser's authority to act as an attorney, accountant, or federal contractor.

Civil Bond: This type of disclosure event involves a civil bond for the adviser that has been denied, paid, or revoked by a bonding company.

Criminal - On Appeal: This type of disclosure event involves a conviction for any felony or certain misdemeanor offenses, including bribery, perjury, forgery, counterfeiting, extortion, fraud, and wrongful taking of property that is currently on appeal.

Criminal - Pending Charge: This type of disclosure event involves a formal charge for a crime involving a felony or certain misdemeanor offenses, including bribery, perjury, forgery, counterfeiting, extortion, fraud, and wrongful taking of property that is currently pending.

Regulatory - On Appeal: This type of disclosure event may involves (1) a formal proceeding initiated by a regulatory authority (e.g., a state securities agency, self-regulatory organization, federal regulator such as the Securities and Exchange Commission, foreign financial regulatory body) for a violation of investment-related rules or regulations that is currently on appeal; or (2) a revocation or suspension of a adviser's authority to act as an attorney, accountant, or federal contractor that is currently on appeal.

Regulatory - Pending: This type of disclosure event involves a pending formal proceeding initiated by a regulatory authority (e.g., a state securities agency, self-regulatory organization, federal regulatory agency such as the Securities and Exchange Commission, foreign financial regulatory body) for alleged violations of investment-related rules or regulations.

Civil - On Appeal: This type of disclosure event involves an injunction issued by a court in connection with investment-related activity or a finding by a court of a violation of any investment-related statute or regulation that is currently on appeal.

A2: FINRA Qualifications and Exams[28]

Series 6 Exam: The Series 6 exam—the Investment Company and Variable Contracts Products Representative Qualification Examination (IR)—assesses the competency of an entry-level representative to perform his or her job as an investment company and variable contracts products representative. The exam measures the degree to which each candidate possesses the knowledge needed to perform the critical functions of an investment company and variable contract products representative, including sales of mutual funds and variable annuities.

[28] Definitions as per http://www.finra.org/industry/qualification-exams?bc=1

Series 7 Exam: The Series 7 exam – the General Securities Representative Qualification Examination (GS) – assesses the competency of an entry-level registered representative to perform his or her job as a general securities representative. The exam measures the degree to which each candidate possesses the knowledge needed to perform the critical functions of a general securities representative, including sales of corporate securities, municipal securities, investment company securities, variable annuities, direct participation programs, options and government securities.

Series 24 Exam: The Series 24 exam—the General Securities Principal Qualification Examination (GP)—assesses the competency of an entry-level general securities principal candidate to perform his or her job as a general securities principal. The exam measures the degree to which each candidate possesses the knowledge needed to perform the critical functions of a general securities principal, including the rules and statutory provisions applicable to the supervisory management of a general securities broker-dealer.

Series 63 Exam: The Uniform Securities Agent State Law Examination was developed by NASAA in cooperation with representatives of the securities industry and industry associations. The examination, called the Series 63 exam, is designed to qualify candidates as securities agents. The examination covers the principles of state securities regulation reflected in the Uniform Securities Act (with the amendments adopted by NASAA and rules prohibiting dishonest and unethical business practices). The examination is intended to provide a basis for state securities administrators to determine an applicant's knowledge and understanding of state law and regulations.

Series 65 Exam: The Uniform Investment Adviser Law Examination and the available study outline were developed by NASAA. The examination, called the Series 65 exam, is designed to qualify candidates as investment adviser representatives. The exam covers topics that have been determined to be necessary to understand in order to provide investment advice to clients.

Series 66 Exam: The Uniform Combined State Law Examination was developed by NASAA based on industry requests. The examination (also called the "Series 66") is designed to qualify candidates as both securities agents and investment adviser representatives. The exam covers topics that have been determined to be necessary to provide investment advice and effect securities transactions for clients.

A3: Additional Figures and Tables

Figure A1: BrokerCheck Examples

(a) BrokerCheck Example



John Doe

This broker is not currently registered.

Report Summary for this Broker

FINRA

This report summary provides an overview of the broker's professional background and conduct. Additional information can be found in the detailed report.

Broker Qualifications

This broker is not currently registered.

This broker has passed:

- 0 Principal/Supervisory Exams
- 1 General Industry/Product Exam
- 2 State Securities Law Exams

Registration History

This broker was previously registered with the following securities firm(s):

INTERNATIONAL ASSETS ADVISORY, LLC
CRD# 10645
ORLANDO, FL
05/2013 - 06/2014

SECURITIES AMERICA, INC.
CRD# 10205
CHARLOTTESVILLE, VA
03/2013 - 04/2013

CAMBRIDGE INVESTMENT RESEARCH, INC.
CRD# 39543
CHARLOTTESVILLE, VA
06/2010 - 04/2013

Disclosure Events

All individuals registered to sell securities or provide investment advice are required to disclose customer complaints and arbitrations, regulatory actions, employment terminations, bankruptcy filings, and criminal or civil judicial proceedings.

Are there events disclosed about this broker? **Yes**

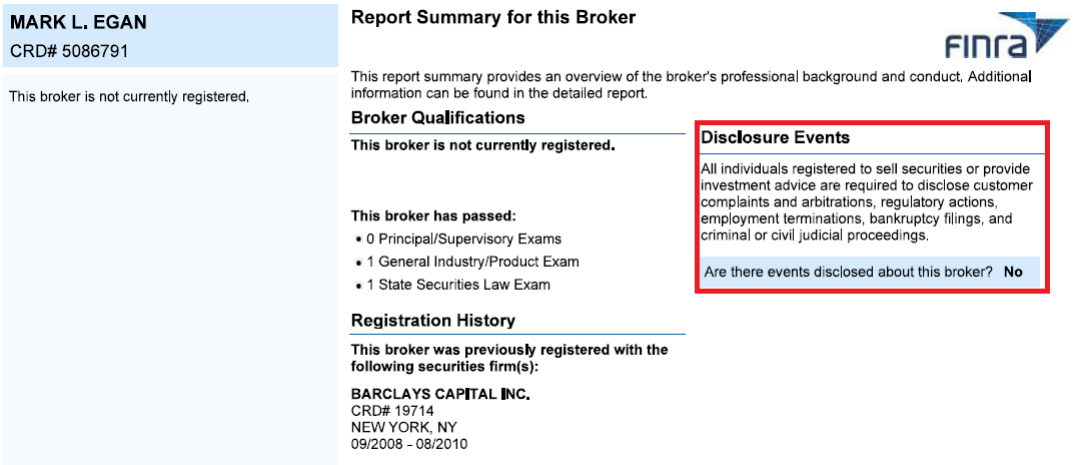
The following types of disclosures have been reported:

Type	Count
Investigation	1
Customer Dispute	2
Termination	2

Investment Adviser Representative Information

The information below represents the individual's record as a broker. For details on this individual's record as an investment adviser representative, visit the SEC's Investment Adviser Public Disclosure website at
http://www.adviserinfo.sec.gov

(b) BrokerCheck Example



MARK L. EGAN
CRD# 5086791

This broker is not currently registered.

Report Summary for this Broker

FINRA

This report summary provides an overview of the broker's professional background and conduct. Additional information can be found in the detailed report.

Broker Qualifications

This broker is not currently registered.

This broker has passed:

- 0 Principal/Supervisory Exams
- 1 General Industry/Product Exam
- 1 State Securities Law Exam

Registration History

This broker was previously registered with the following securities firm(s):

BARCLAYS CAPITAL INC.
CRD# 19714
NEW YORK, NY
09/2008 - 08/2010

Disclosure Events

All individuals registered to sell securities or provide investment advice are required to disclose customer complaints and arbitrations, regulatory actions, employment terminations, bankruptcy filings, and criminal or civil judicial proceedings.

Are there events disclosed about this broker? **No**

Figure A1: BrokerCheck Examples

(c) BrokerCheck Example

Customer Dispute - Settled

This type of disclosure event involves a consumer-initiated, investment-related complaint, arbitration proceeding or civil suit containing allegations of sale practice violations against the broker that resulted in a monetary settlement to the customer.

Disclosure 1 of 1

Reporting Source:	Firm
Employing firm when activities occurred which led to the complaint:	STATE FARM VP MANAGEMENT CO.
Allegations:	ALLEGATIONS INDIVIDUAL STOLE MONEY FROM CUSTOMER'S ACCOUNTS, OPENED ACCOUNTS IN CUSTOMER'S NAME WITHOUT HER KNOWLEDGE AND CONSENT, AND FRAUDULENTLY USED CUSTOMER'S DEBIT CARD. ACTIVITY IS ALLEGED TO HAVE OCCUREED BETWEEN JULY 8, 2008 AND APRIL 28, 2011.
Product Type:	Annuity-Fixed Banking Products (other than CDs) Mutual Fund
Alleged Damages:	$0.00
Alleged Damages Amount Explanation (if amount not exact):	NO SPECIFIC AMOUNT CLAIMED. DAMAGES ALLEGED WOULD BE IN EXCESS OF $5,000.

Arbitration Information

Arbitration/CFTC reparation claim filed with (FINRA, AAA, CFTC, etc.):	FINRA
Docket/Case #:	12-04177
Date Notice/Process Served:	12/26/2012
Arbitration Pending?	No
Disposition:	Settled
Disposition Date:	01/30/2014
Monetary Compensation Amount:	$40,000.00

Figure A1 panels (a)-(c) display three real-world examples of BrokerCheck reports. The name/identification details in panel (a) have been intentionally omitted by the authors of this paper.

Table A1: What Types of Firms do Advisers Switch To?

	Firm Size	Misc. Rate	Assets ($bn)	Rev($mm)	Avg. Payout	No. Social Links
Misconduct	-1,498***	0.00502***	-18.40**	-219.7***	-6,861	-18,639***
	(340.8)	(0.000821)	(7.50)	(56.8)	(4,548)	(5,079)
Firm x Year x County F.E.	X	X	X	X	X	X
Observations	162,314	162,314	21,790	21,704	19,630	5,251
R-squared	0.001	0.013	0.001	0.006	0.007	0.005

Table A1 displays the characteristics of new firms joined by advisers who switched firms as a function of whether or not the adviser was disciplined for misconduct in the year prior to the job transition. Specifically we regress the new firms characteristic (size, misconduct rate, etc.) on a dummy variable Misconduct which indicates whether or not the adviser was disciplined for misconduct in the year prior to his/her job transition. Observations are adviser by job transition where the adviser found a job in the same year. Each specification also includes a year by county by original/previous firm fixed effect. Conceptually this allows us to compare the job outcomes of advisers that were working for the same firm who *were* and *were not* disciplined for misconduct prior to switching jobs. We restrict the data set to include only those observations where we observe advisers leaving a given firm in a given year where both advisers who were and were not disciplined for misconduct left. The dependent variable misconduct rate is defined as the percentage of advisers currently working for a firm that were disciplined for misconduct in the year prior to the new adviser joining the firm. We only observe Asset, Revenue, Average Payout/Salary, and Social Network Link data for a small subset of firms. The Asset, Revenue, Average Payout/Salary and Social Network Link data is all measured as of 2015. Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.10.

Table A2: Misconduct Per Employee Across Industries (2010)

State	Adviser Misconduct		Medical Malpractice	Public Corruption
	All Advisers	Retail Advisers		
New York	0.74%	1.36%	2.04%	0.00%
California	1.24%	1.66%	0.96%	0.00%
Illinois	0.72%	0.97%	0.95%	0.01%
Texas	0.79%	0.86%	0.99%	0.00%
Florida	1.60%	1.94%	1.71%	0.01%
New Jersey	0.98%	1.36%	1.75%	0.01%
Pennsylvania	0.84%	1.18%	2.05%	0.01%
Ohio	1.03%	0.98%	0.77%	0.01%
Massachusetts	0.83%	1.44%	0.84%	0.01%
North Carolina	0.56%	0.85%	0.59%	0.00%
Total US	**0.97%**	**1.35%**	**1.20%**	**0.00%**

Note: Table A2 displays the incidence of misconduct, medical malpractice and public corruption per employee as of 2010 among the ten states with the highest level of misconduct related incidences as of 2010. Column (1) displays the share of advisers in 2010 in each state that were disciplined for misconduct. Column (2) displays the share of financial advisers in 2010 that were disciplined for misconduct among those advisers who hold a Series 65 or 66 license (retail oriented advisers). Column (3) displays the number of medical malpractice cases per doctor.[29] Column (4) displays the number of public corruption cases per public employee. [30] .

Table A3: Investment Adviser Subsample Analysis

(a) Incidence of Misconduct

	Current Misconduct	Current & Past Misconduct
Investment Advisers	0.85%	10.01%
Non-Investment Advisers	0.43%	5.39%

(b) Consequences of Misconduct: Investment Advisers

	Misconduct	Firm Sep.	Ind. Sep.	New Employment	Unemp. Duration
Misconduct	0.0191***	0.203***	0.122***	0.0812***	0.820***
	(0.000911)	(0.0128)	(0.00974)	(0.00627)	(0.00803)
Other Adviser Controls	X	X	X	X	X
Year×Firm×County F.E.	X	X	X	X	
Year F.E.					X
	3,050,125	2,780,596	2,780,596	2,780,596	535,917
R-squared	0.111	0.379	0.146	0.392	

(c) Consequences of Misconduct: Non-Investment Advisers

	Misconduct	Firm Sep.	Ind. Sep.	New Employment	Unemp. Duration
Misconduct	0.0180****	0.302***	0.259***	0.0434***	0.856
	(0.000873)	(0.0306)	(0.0362)	(0.00942)	(0.0109)
Other Adviser Controls	X	X	X	X	X
Year×Firm×County F.E.	X	X	X	X	
Year F.E.					X
	4,476,221	4,110,462	4,110,462	4,110,462	821,129
R-squared	0.117	0.319	0.172	0.366	

(d) What Types of Firms do Investment Advisers Switch To: Investment Advisers

	Firm Size	Misc. Rate	Assets ($bn)	Rev. ($mm)	Avg. Payout	No. Social Links
Misconduct	-2,363***	0.00377***	-42.37e+10***	-431***	-14,327***	-9,175***
	(288.2)	(0.000482)	(5.47)	(44)	(4,289)	(1,876)
Orig Firm x Year F.E.	X	X	X	X	X	X
Observations	250,539	250,539	39,832	39,644	37,128	11,732
R-squared	0.002	0.004	0.000	0.004	0.002	0.002

(e) What Types of Firms do Investment Advisers Switch To: Non-Investment Advisers

	Firm Size	Misc. Rate	Assets ($bn)	Rev. ($mm)	Avg. Payout	No. Social Links
Misconduct	-1,407***	0.00765***	-31.21***	-370***	-25,567***	-8,490***
	(220.3)	(0.00109)	(7.68)	(73)	(5,184)	(2,450)
Orig Firm x Year F.E.	X	X	X	X	X	X
Observations	143,995	143,995	22,152	22,053	18,781	9,336
R-squared	0.003	0.016	0.000	0.005	0.006	0.004

Note: In Table A3 we recompute our baseline analysis where we restrict our data set to only those advisers who are and are not registered as investment advisers. We only observe whether a financial adviser is registered as an investment adviser if the financial adviser is currently active in the industry. Hence, we treat all advisers who have completed an investment adviser examination (Series 65 or 66 exam) as being investment advisers. The results reported in Tables A3b and A3d are estimated using the set of investment advisers in the data. Tables A3c and A3e display the corresponding estimates for the pool of non-investment advisers.
Table A3a displays the incidence of misconduct among financial advisers that are and are not registered as investment advisers. Column (1) displays the average share of financial advisers who are disciplined for misconduct in a given year. Column (2) displays the share of advisers in our dataset who have ever been disciplined for misconduct (current or previously). Observations are year by financial adviser over the period 2005-2015.
Tables A3b and A3c display the estimated results for the baseline analysis in the model where we restrict the sample to those advisers who are and are not registered as investment advisers. Columns (1)-(4) correspond to linear probability models that were estimated using adviser by year data. In column (1), the dependent variable is a dummy variable indicating whether or not the investment adviser was formally disciplined for misconduct in year t. In column (2), the dependent variable is a dummy variable indicating whether or not the investment adviser experienced a job separation. In column (3), the dependent variable is a dummy variable indicating whether or not the investment adviser left the financial services industry for at least one year. In column (4), the dependent variable is a dummy variable indicating whether or not the investment adviser switched firms in a given year. Column (5) displays the estimates corresponding to a Cox-Proportional Hazards Model. The dependent variable is the length of an unemployment spell in months. The coefficients in column (5) are reported in terms of proportional hazards such that a coefficient less than one indicates that it takes longer for an adviser to find a new job. Observations are adviser by unemployment spell. The key independent variables of interest are the misconduct dummy variables. In column (1) the misconduct variable indicates whether or not the adviser has ever been previously discliplined for misconduct. In columns (2)-(5) the disclosure variable indicates whether or not the adviser was disciplined for misconduct in the previous year. Other adviser controls include the advisers experience, tests (series 6, 7, 63, 24 and investment adviser exam), and number of other qualifications.
Tables A3d and A3e display the characteristics of new firms joined by advisers who switched firms as a function of whether or not the adviser was disciplined for misconduct in the year prior to the job transition. Specifically we regress the new firm characteristic (size, misconduct rate, etc.) on a dummy variable Misconduct which indicates whether or not the adviser was disciplined for misconduct in the year prior to his/her job transition. Observations are adviser by job transition where the adviser found a job within a year. Each specification also includes a year by original/previous firm fixed effect. Conceptually this allows us to compare the job outcomes of advisers that were working for the same firm who *were* and *were not* disciplined for misconduct prior to switching jobs. We restrict the data set to include only those observations where we observe investment advisers leaving a given firm in a given year where both advisers who were and were not disciplined for misconduct left. Standard errors are clustered by firm. *** $p<0.01$, ** $p<0.05$, * $p<0.10$.