Wandering Financial Advisors

WANDERING FINANCIAL ADVISORS

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Abstract

Millions of Americans rely on professional advisors to oversee their personal finances. Financial-advisor misconduct has significant consequences for investors, so a wide range of federal, state, and self-regulatory institutions have authority to detect and deter such misconduct. But each regime takes meaningfully different approaches to these tasks, creating incentives for advisors, particularly those with a history of harming investors, to seek a more lax regulatory environment. Although academics and policymakers are engaged in heated debates over the regulation of financial advice, no prior work has identified these “wandering” financial advisors.

Using a novel dataset of 1.2 million advisors across four major regulatory regimes, this Article provides the first systematic analysis of wandering financial advisors. We show that a little over a third of advisors who exit the brokerage industry remain in at least one other regime, that advisors are significantly more likely to change regimes after committing serious misconduct, and that wandering advisors with a history of misconduct are significantly more likely to engage in future...
misconduct. Further, we find that wandering advisors with a history of serious misconduct disproportionately end up in the highly-fragmented state insurance regimes. We consider explanations for why advisors wander—and offer policymakers concerned about the costs of financial-advisor misconduct with tools to address this phenomenon.

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INTRODUCTION

In March 2017, the brokerage industry permanently expelled Frank Black, a longtime financial advisor. Industry authorities concluded that, over the previous decade alone, Mr. Black had lied during an examination of his firm’s finances, engaged in excessive trading in his customers’ accounts and recommended unsuitable securities to clients—all claims that Mr. Black denied.1 But rather than continue to contest these allegations, Mr. Black simply decided to continue his work as an insurance producer registered with the State of North Carolina.2 Today, he oversees the work of 85 financial advisors across 48 states. His firm’s website describes his decades-long brokerage career, making no mention of his lifetime ban.3 Instead, the firm advertises its services by quoting Mr. Black’s long experience—and his claim that, when it comes to giving investment advice, “[c]lient[s come] first. End of story.”4

1 FINANCIAL INDUSTRY REGULATORY AUTHORITY (FINRA), BROKERCHECK, FRANK HARMON BLACK (CRD No. 22451) (noting that FINRA permanently barred Mr. Black from the brokerage industry in 2017 in light of allegations that he lied during a FINRA examination, following the Washington State Securities Division’s 2015 decision to charge Mr. Black with excessive trading generating $5.3 million in commissions, an arbitrator’s 2014 finding that he recommended unsuitable investments, and an Oklahoma State Department of Securities’ 2013 order that he failed to supervise his firm).

2 NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, NORTH CAROLINA STATE BASED SYSTEMS, LICENSEE DETAILS, FRANK H. BLACK (NPN No. 5630059) (documenting Mr. Black’s insurance-producer registration under North Carolina law).

3 SOUTHEAST INVESTMENTS, N.C., INC., ABOUT US (“During Frank’s sophomore year a Merrill Lynch broker came into his business class and explained what a stock was. Frank immediately went out and bought one share of stock and instantly fell in love with the market. . . . With this story and [thirty years’ experience with Merrill Lynch, E.F. Hutton, and Raymond James] behind him, Frank founded Southeast Investments . . . which brings us to today.”) (last accessed January 10, 2021).

4 Id.
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American investors increasingly rely on professional financial advisors like Mr. Black. But today a fragmented set of federal, state, and self-regulatory institutions separately oversee financial advisors, with each institution drawing on different legal authority and budgetary resources. Thus, while many investors experience financial advice as an undifferentiated product, in fact financial advisors are subject to widely varying oversight. These differences create incentives for some

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5 For millions of American workers, the generational shift from defined-benefit pension plans, under which employers were responsible for allocating worker savings to investments, to defined-contribution plans that require workers to make those decisions, makes financial advice increasingly indispensable. See, e.g., JULIA LYNN CORONADO & PHILLIP C. COPELAND, CASH BALANCE PENSION PLAN CONVERSIONS AND THE NEW ECONOMY, FEDERAL RESERVE FINANCE & ECONOMICS WORKING PAPER SERIES (2003) (documenting the relative rise of defined-contribution plans in which participants make key investment decisions). To be sure, a wide range of policy motivations helped produce this shift. For purposes of this Article, we put to one side the wisdom of the policy changes that have produced the move toward defined-contribution retirement savings. Instead, we focus on the pressure that shift has placed on the law and institutions that govern the provision of financial advice in the United States. See infra Part II.


7 ANGELA A. HUNG ET AL., RAND CORPORATION, INVESTOR TESTING OF FORM CRS RELATIONSHIP SUMMARY (November 2018), at 48 (noting, in a field survey, that “interview discussions revealed that there were areas of confusion for participants, including differences between types of . . . ‘financial professionals’”); see also Tara Siegel Bernard, Making Brokers Toe the Mark, N.Y. TIMES (Feb. 13, 2015) (“There is a big difference between [brokers] and true investment advisers, and yet the onus is on
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advisors—particularly those with a history of misconduct—to seek out the regime in which prior misconduct is least costly for the advisor’s prospects. Drawing on recent work examining police, teachers, and clergymen who move across jurisdictions, in this Article we identify these as “wandering” financial advisors.8

In this Article, we provide the first systematic investigation of wandering financial advisors. Drawing on a unique dataset of 1.2 million advisors across four different legal contexts, we offer three principal findings. First, wandering advisors are not uncommon: of the nearly 400,000 advisors who leave the brokerage industry, we show that one-third continue their work in at least one other legal regime. (Notably, we find that advisors with a history of serious misconduct are roughly 25% more likely to change regimes.) Second, wandering advisors with a prior record of misconduct have a heightened propensity for future wrongdoing: these advisors are over 40% more likely to be recidivists relative to other advisors with misconduct who do not change regulatory regimes. Third, of those wandering advisors who, like Mr. Black, leave the brokerage industry after serious misconduct, the majority—like Mr. Black—continue to work as state-registered insurance producers.

consumers to figure it all out.”); Judith Burns, Broker? Adviser? Investors See Small Difference, But Is That Good? WALL ST. J. (Jan. 4, 2008) (“Although the lines between the brokers and investment advisers are blurring, they remain subject to different regulations and laws written in the 1930s and 1940s.”).

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Our findings offer insights for academics and lawmakers now engaged in vigorous debate over the regulation of financial advice. Policymakers and scholars have urged adoption of legal standards that might better deter misconduct by advisors within each regime, but little attention has been paid to the incentives such standards might create to switch regulatory regimes.9 Important recent academic work examines the degree to which market discipline—the loss of an advisor’s job or clientele—deters misconduct, but does not consider whether advisors can avoid those consequences by wandering.10 Advisors’ freedom to wander may undermine market discipline and frustrate regulatory oversight. Therefore, we offer lawmakers tailored policy alternatives to address this phenomenon and improve mechanisms for market discipline.

The Article proceeds as follows. Part I provides background on the increasingly important role of financial advisors in household investment decisions. Part II analyzes four separate regulatory regimes that license financial advisors. Part III describes our dataset and provides empirical evidence on the incidence and implications of wandering financial advisors. Part IV discusses alternatives for policymakers seeking to address the costs of wandering financial advisors. Part V concludes.


Wandering Financial Advisors

I. THE ECONOMICS OF FINANCIAL ADVISOR MISCONDUCT

Financial advisors today play an increasingly important role in individuals’ investment decisions, exacerbating long-understood costs of advisor misconduct. In this Part, we document the increasing scope of financial advisors’ responsibility and the costs that arise when advisors engage in misconduct, linking that literature to emerging work arguing that disparate legal regimes encourage regulated actors with histories of misconduct to wander toward a more lax regulatory environment.

A. The Importance of Financial Advisors

In 2019, some 56.5% of American families contacted a financial advisor for assistance in making investment decision, reporting in surveys that they relied on financial advisors for assistance with their investment decisions more than they relied on any other source.11 Although such advice can be expensive, research documents that the costs of investing without the benefit of advice are even higher—especially for unsophisticated consumers.12 What’s more, the number and influence of

12 On this view, the growth of the financial-advice industry is best explained by growing demand for these services. Nicola Gennaioli, Andrei Shleifer & Robert Vishny, Finance and the Preservation of Wealth, 129 Q. J. Econ. 1221 (2014); see also Robin Greenwood & David Scharfstein, The Growth of Finance, 27 J. Econ. Persp. 3 (2013). Particularly for unsophisticated consumers, there are strong arguments that the benefits of financial advice outweigh its costs. See, e.g., Hans-Martin Von Gaudecker, How Does Household Portfolio Diversification Vary with Financial Literacy and Financial Advice?, 70 J. Fin. 489 (2015) (finding that households with below-median financial literacy that do not use a financial professional lose, on average, 50 basis points in expected returns relative to households that use financial professionals or are financially literate).
financial advisors is likely to increase in the future. As of May 2020, Americans held some $32.3 trillion in retirement assets—representing roughly one-third of all household assets—that will increasingly be deployed on the basis of professional investment advice.13

Yet unlike doctors or lawyers, there is no legal requirement that financial advisors have particular a professional qualification or license. To be sure, there are scattered professional designations, such as the Certified Financial Planner (CFP) and Chartered Financial Analyst (CFA) associations, over fifty exam qualifications, and at least four different regulatory regimes that facilitate the delivery of investment advice. But while millions of individuals work as professional financial advisors, there is no agreed-upon degree or designation that qualifies one to do that work. Of course, the industry’s variation and fragmentation makes sense given the wide range of services that advisors give to a wide range of clients.14 To some degree, we do not find the fragmented structure of the modern financial-advice industry surprising.

The problem is that consumers do. Most Americans experience financial advice as an undifferentiated product, making no distinction among the individuals who execute their stock trades, advise them on their 401(k) investments, and sell them life insurance linked to the performance of a stock-market index—even though each of these three individuals is

13 INVESTMENT COMPANY INSTITUTE, INVESTMENT COMPANY FACTBOOK 44 (2020). In fact, the amount of retirement assets held by American families increased by some $14.4 trillion (nearly 80%) over the eight year period from 2012 to 2020. See id.

14 The financial needs and risk tolerance of each individual and institution are unique, of course, and advising with respect to different products will require different expertise. Consider, for example, the wide variation that exists even among life insurance products: a basic life insurance policy that pays a multiple of the decedent’s salary upon her death is far more straightforward than a variable life insurance policy for which payout is linked to the value of a basket of securities.
subject to a different legal regime. Thus, even though there is increasing awareness among regulators that consumers do not understand the differences among financial advisors, historically lawmakers have focused on regulation within each particular type of advice.

Perhaps as a result, consumers seem to have a negative view of the financial-advice profession. One recent survey concluded that the financial services sector is the least trusted industry in the national economy; another found that consumers were more likely to trust their Uber driver than their financial advisor. And the regulatory patchwork may contribute to consumers’ negative view of advisors. Anecdotal evidence

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15 As explained infra at Part II, the first individual is a “broker-dealer representative”; the second is an “investment adviser representative”; and the third is an “insurance producer” (assuming the product meets the definition of a fixed indexed annuity). Because individuals can be registered in multiple regimes, it is possible that these individuals would be subject to the aforementioned regimes and others beyond those noted here. SECURITIES AND EXCHANGE COMMISSION, supra note 9, at 95 & nn. 448-449 (noting the “lack of investor understanding and general investor confusion regarding the roles of broker-dealers and investment advisers” (citing several letters from individuals expressing confusion as to the law governing financial advice)).

16 For example, during the recent adoption of federal standards governing brokers and investment advisers, the SEC emphasized that these professionals should be regulated differently—despite evidence that consumers do not view them differently. See Chairman Jay Clayton, Statement at Open Meeting on Commission Actions to Enhance and Clarify the Obligations Financial Professionals Owe to our Main Street Investors (June 5, 2019) (“[W]hile both broker-dealers and investment advisers play important roles in helping retail investors achieve their long-term financial goals, they do so in significantly different ways . . . . Accordingly, . . . the obligations applicable to each type of financial professional should reflect these different characteristics.”)

17 See EDELMAN SERVICES, EDELMAN TRUST BAROMETER: FINANCIAL SERVICES REPORT (2019); Anna Prior, Brokers are Trusted Less than Uber Drivers, Survey Finds, WALL. ST. J. (July 28, 2015).
indicates that consumers believe that their advisors owe them a higher
duty of loyalty than the law in fact requires.18

Financial advisors are likely unpopular with consumers for another
reason: misconduct appears to be widespread in the profession. In the next
section, we consider such misconduct in more detail, drawing from the
literature documenting the costs advisor misconduct impose on investors.

B. The Costs of Advisor Misconduct

According to a recent study, one in thirteen financial advisors have
one or more allegations of misconduct in their history.19 Among advisors
with allegations of misconduct, approximately 25% are repeat offenders.
And these striking statistics probably understate the actual degree of
advisor misconduct.20

18 See Kelli Alces Williams & Justin Sevier, Consumers, “Seller-Advisors,” and
the Psychology of Trust, 59 B.C. L. REV. 931 (2018) (“[A] problematic mismatch can
develop between the expectations of the consumer and the behavior of the seller advisor:
the consumer may mistakenly believe that her expectations of trust and confidence with a
seller-advisor are legally protected or even practically justified, and may be unaware that
the seller-advisor has no legal duty to act in her best interest”).

19 For comparison, the rate of misconduct in financial advisors is significantly
higher than the frequency of corruption of public employees (less than 0.01 percent), but
comparable to the annual incidence of medical malpractice (around 1 percent). However,
medical malpractice is much more widely distributed throughout the profession than
financial advisor misconduct, which tends to be concentrated in a small percentage of the
population. For a discussion of this issue, see Egan et. al, supra note 10, at 4.

20 One reason is that, as explained in Colleen Honigsberg & Matthew Jacob,
Deleting Misconduct: The Expungment of BrokerCheck Records (J. FIN. ECON.,
forthcoming 2021), the brokerage industry’s oversight authority allows brokers to delete,
or “expunge,” evidence of prior misconduct complaints from publicly available records
of broker histories. See id. at 4.
Because advisors provide a wide range of services, in this context the term “misconduct” spans a wide range of activities. At one extreme is fraud: forging client signatures, stealing client assets, and so on. But most financial advisor misconduct is not so obviously improper. Consider, for example, “churning,” or excessive trading on a client’s behalf to maximize an advisor’s sales commissions. Because there is nothing inherently wrong with an advisor making trades on a client’s behalf, identifying misconduct requires analysis over whether the trades were intended to benefit the client or maximize commissions. Similarly, although there is evidence that advisors steer clients toward investments that earn lower returns for the consumer but higher commissions for the broker, whether that amounts to advisor misconduct depends on the facts of the particular case.22


22 Consider, for example, a retiree considering a product known as an equity-indexed annuity with a “rate cap” of 2% and a fifteen-year “surrender charge” schedule with a 20% penalty. The basic product—an equity-indexed annuity—provides a fixed, annual payment with an interest rate linked to a stock-market index, and is desirable for many investors. But this product caps the annual interest rate at 2%, depriving the investor of further gains, and imposes a 20% penalty (the “surrender charge”) on those who withdraw the funds before the end of a fifteen-year period. Those terms make this product a poor choice for this retiree, but the advisor selling the product is likely to be rewarded with a substantial commission. Whether an advisor who makes this
Notwithstanding these ambiguities, reports of advisor misconduct are common—and the reported costs of that misconduct are significant. One recent study found that the average settlement of customer claims of broker misconduct between 2005 and 2015 was over $500,000, and in total these settlements cost brokers nearly half a billion dollars each year.\textsuperscript{23} And those harmed by financial advisor misconduct are disproportionately older and less educated: rates of misconduct are 19% higher in counties that rank below national averages in household income and education.\textsuperscript{24} One survey of elderly individuals found that, over the past five years, nearly 5% of these individuals were the victim of an investment fraud.\textsuperscript{25}

On top of economic costs, evidence shows that victims of financial misconduct suffer psychological harm. These victims are, on average, more likely to suffer from broken relationships, reputational damage and health problems, consequences that reverberate throughout communities.\textsuperscript{26} And, because financial advisors influence investment allocation decisions,

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\textsuperscript{23} Egan et al., supra note 10, at 4 (finding that the median settlement paid to consumers during this period was $40,000, and the mean was $550,000). \\
\textsuperscript{24} See id.; see also Umit Gurun, Gregor Matvos & Amit Seru, Advertising Expensive Mortgages, 71 J. FIN. 2371 (2016). \\
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advisor misconduct may result, more broadly, in an inefficient allocation of scarce capital resources.\textsuperscript{27}

C. Financial Advisors and Regulatory Wandering

Despite the well-known costs of financial advisor misconduct, little prior work has examined the porous boundaries dividing regulatory regimes in this area—and the incentives this gives advisors to wander.\textsuperscript{28} There is growing literature documenting regulatory wandering across different professions, such as teachers,\textsuperscript{29} clergy,\textsuperscript{30} and most notably, police officers. Professors Grunwald and Rappaport examine law enforcement officers who are fired—or resign under threat of termination—and later work in law enforcement in another department. They show that roughly three percent of all officers in the state of Florida, in any given year, were

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27 For a discussion of this issue in the corporate context, see Simi Kedia & Thomas Philippon, \textit{The Economics of Fraudulent Accounting}, 22 REV. FIN. STUD. 2169 (2009) (showing, in a theoretical model, that misconduct can distort resource allocation).

28 Although we are not aware of literature on wandering advisors, there is an extensive literature on regulatory evasion and leakage in financial services more generally. See, e.g., George Aragon, Bing Liang & Hyuna Park, \textit{Onshore and Offshore Hedge Funds: Are They Twins?}, 60 MGMT. SCI. 1 (2014) (concluding that a small percentage of hedge funds left the US to avoid federal regulation); Terrence L. Chapman, Nathan M. Jensen, Edmund Malesky & Scott Wolford, \textit{“Leakage” in International Regulator Regimes: Did the OECD Anti-Bribery Convention Increase Bribery?} (working paper 2019) (demonstrating that anti-bribery laws can reduce bribery among firms in affected countries while increasing bribery in firms in unaffected countries).


30 See OFFICE OF THE PENNSYLVANIA ATTORNEY GENERAL, REPORT OF 40TH STATEWIDE INVESTIGATING JURY 12, 77, 85 (2018) (documenting instances in which priests accused of sexual abuse were reassigned to other jurisdictions without disclosure of prior allegations of misconduct).
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previously fired, and that these officers were more likely to be fired from their next job or to receive a complaint for a “moral character violation.”

Although our study is similar to theirs, we note several differences suggesting that policy solutions in the police-officer context could not be readily applied to wandering financial advisors. First, unlike police officers, who work for one department at a time, financial advisors are commonly registered with multiple regulators simultaneously. In our context, wandering is more likely to occur when an advisor with multiple regulatory “hats” drops one and continues her work, rather than joining an entirely distinct regime. Second, a financial advisor’s misconduct history is relatively easy to identify through public databases; by contrast, misconduct by police officers and clergy is more difficult to identify. Finally, some observers of financial regulation take the view that consumers may appropriately bear the costs of misconduct by repeat bad actors, a much less common perspective for victims of misconduct by public officials.

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31 Ben Grunwald & John Rappaport, The Wandering Officer, 129 YALE L. J. 1600, 1644 (2020). In light of the distinct context, that study defines wandering officers somewhat differently than we define wandering financial advisers. See id.

32 For this reason, prior work on police officers has highlighted the importance of a national database that would allow police departments to identify individuals with questionable history in a more efficient and cost-effective manner. Id.; see also Monica C. Bell, Police Reform and the Dismantling of Legal Estrangement, 126 YALE L.J. 2054, 2137 n.304 (2017).

33 For example, if a teacher who sexually assaults a student is hired by another district and again commits that misconduct, the district will be faulted for hiring this teacher—and may be held civilly liable. See, e.g., Julia Sanchez, Students Are Being Retraumatized When They Report Sexual Assault. Here’s How to Stop It, SACRAMENTO BEE (June 25, 2019). In that context, few would blame the student who was victimized by the teacher’s behavior. By contrast, in the financial-services context, regulators are more
In sum, financial advisors play an increasingly important role in determining economic outcomes for individual investors, but it is well-understood that advisors frequently engage in costly misconduct. And although legal scholarship has increasingly studied the degree to which regulatory boundaries encourage wandering among regulatory regimes, we are aware of no systematic study of how financial advisers select among the different legal standards that govern their work. In the next Part, we describe those different legal regimes in detail.

II. THE LAW OF FINANCIAL-ADVISOR MISCONDUCT

In light of the importance of advisor misconduct for investors, a range of regulatory institutions have arisen to govern such misconduct. These regimes generally rely on a mix of disclosure and substantive conduct regulation. But as we have noted, those institutions frequently take meaningfully different approaches to using those tools, giving advisors reason to select among regimes.

In this Part, we provide a description of four institutional contexts in which investment advice is commonly provided in the United States.34
First, we consider broker-dealer regulation—that is, the oversight of brokers who execute transactions, and offer limited investment advice, for commission-based compensation. Second, we describe the law governing investment adviser representatives, who provide advice in exchange for fees calculated as a percentage of the assets they manage. Third, we describe the law governing state-registered insurance producers, who often provide a wider range of financial services than their title suggests. Finally, we assess institutional oversight for commodities dealers.

A. Regulation of Broker-Dealers

The stockbrokers so familiar in popular culture are, as a legal matter, known as registered representatives at firms subject to broker-dealer oversight. They represent clients on behalf of a licensed firm, which sponsors their registration with FINRA and must oversee their conduct. Brokerage firms, in turn, are overseen by both FINRA and the SEC. As (2012) (citing 12 C.F.R. Part 9), and certain state laws governing the activities of broker-dealers, such as bonding, net capital, custody, and financial reporting obligations, see, e.g., ARK. CODE REV. § 308.01 (2018), FLA. ADMIN. CODE ANN. 69W-600.013, and N.J. STAT. ANN. § 49:3-58 et seq. To be sure, those regulatory regimes can have important implications for the work of financial advisors. For purposes of this Article, however, we focus on the four principal regimes pursuant to which advisors do their work.

35 For helpful analysis of the increasing degree to which insurance producers provide financial advisory services, see, e.g., Daniel Schwarcz & Peter Siegelman, The Changing Role of Insurance Intermediaries in the 21st Century, in RESEARCH HANDBOOK ON THE ECONOMICS OF INSURANCE LAW (2015).

36 For ease of exposition, we refer to these advisors as “FINRA brokers,” though popular culture might prefer a different phrase. MARTIN SCORCESE, DIR., THE WOLF OF WALL STREET (Paramount Pictures 2013) (providing an unflattering depiction of a broker’s work); BEN YOUNGER, DIR., BOILER ROOM (New Line Cinema 2000) (same); OLIVER STONE, DIR., WALL STREET (Paramount pictures 1987) (same). Although the SEC
of 2019, more than 620,000 individuals were employed in this regime.\textsuperscript{37} Although we focus here on the regulatory requirements for individuals subject to this regime, the law imposes additional requirements on the firms themselves.\textsuperscript{38}

Regulation of FINRA brokers primarily takes three forms: substantive conduct regulation, disclosure, and enforcement to ensure compliance with conduct and disclosure rules. As to the former, until recently FINRA brokers were subject to a “suitability” standard requiring only that brokers recommend suitable investments based on “reasonable diligence” of an investor’s profile.\textsuperscript{39} Notably, FINRA brokers do not have

invests significant resources in broker-dealer oversight, detection and disclosure of broker misconduct is today largely overseen by FINRA.

\textsuperscript{37} \textsc{Financial Industry Regulatory Authority, Industry Snapshot: A Report from the Financial Industry Regulatory Authority} (2019).

\textsuperscript{38} Under SEC rules developed pursuant to the Securities Exchange Act of 1934, broker-dealer firms must register with the Commission and disclose on Form BD certain details about the firm and its activities and update those disclosures on a regular basis. \textit{See} Securities Exchange Act of 1934, 15 U.S.C. § 78c \textit{et seq.}; \textit{see also} SEC, \textsc{Staff of the Division of Trading and Markets, Guide to Broker-Dealer Regulation} (2008) (providing detail on disclosures required by registering firms). The SEC also requires the firm to register for oversight with a self-regulatory organization, including FINRA and any national securities exchange that require registration for the broker-dealer’s activities. \textit{See id.} Firms must also pay an initial registration fee.

\textsuperscript{39} The SEC recently adopted a new rule, known as Regulation Best Interest, that builds on the FINRA suitability rule, imposing additional substantive and disclosure obligations on brokers who provide financial advice. \textit{See} SEC, \textit{Final Rule, Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release No. 34-86031} (Sept. 10, 2019). Compliance with these rules was not required until June 30, 2020, \textit{see id.} at 4. Thus, brokers in our sample were subject only to the “suitability” standard, under which brokers were expected to have a “reasonable basis” to believe that their advice was suitable for the client based on “reasonable diligence” of their investment profile and risk tolerance. \textit{See} FINRA, \textsc{Rules and Guidance, Rule 211: Suitability} (2018).
a fiduciary duty to their clients, which remains a significant area of confusion for investors, and a controversial topic in policy circles.40

As to disclosure, FINRA requires that firms file and regularly update Form U-4, which provides information for each registered representative’s background and information about prior regulatory actions, customer complaints, and the results of any related arbitration or litigation.41 These disclosures are used to assess individuals’ fitness to serve as brokers42 and to allow customers and firms to monitor broker misconduct. FINRA records the disclosures in Form U-4 in a centralized database known as CRD; much of the information in CRD is made available to the public through FINRA’s BrokerCheck website. BrokerCheck is free, easily accessible, and provides sufficiently important information that it can be used to predict future misconduct.43 Making substantial disclosure freely available in BrokerCheck, which both

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40 See, e.g., SEC Commissioner Robert J. Jackson, Jr., Statement on Final Rules Governing Investment Advice (June 5, 2019).
41 See FINANCIAL INDUSTRY REGULATORY AUTHORITY, FORM U-4 (providing the thirty-nine page form firms are required to file for each registered representative).
42 For example, individuals must undergo an FBI background check and are subject to qualification testing as part of the registration/licensing process. FINRA uses this information to assess the applicant’s capability to comply with applicable rules and regulations, and it rejects applicants from those individuals it deems to lack the necessary character and fitness. To maintain their license, individuals must complete ongoing FINRA-developed, computer-based training and remain in good standing. See id.
43 See, e.g., Egan et al., supra note 10, at 14 (describing BrokerCheck); Honigsberg & Jacob, supra note 20, at 4; Hammad Qureshi & Jonathan S. Sokobin, Do Investors Have Valuable Information About Brokers? (FINRA Office of the Chief Economist Working Paper, 2015), at 2 (concluding that publicly available information in BrokerCheck predicts a considerable proportion of broker misconduct).
customers and firms can access when considering hiring a broker, is thought to aid private monitoring and market discipline.44

Misconduct among FINRA brokers is policed through a system of robust inspection and enforcement programs. Together, the SEC and FINRA45 examined over 1,700 firms in 2019,46 or just under half of the total number of registered broker-dealers.47 FINRA’s examination budget for 2020 alone was over $270 million.48 Deficiencies identified in FINRA examinations can be referred to FINRA’s enforcement division.49

44 Egan et al., supra note 10, at 14; Qureshi & Sokobin, supra note 43, at 2.
45 Although both the SEC and FINRA have dedicated groups that inspect broker-dealer firms for compliance with their respective rules, the SEC’s team is relatively small. SECURITIES AND EXCHANGE COMMISSION, OFFICE OF INSPECTOR GENERAL OFFICE OF AUDITS, THE SEC’S OFFICE OF BROKER-DEALER FINANCES PROVIDES EFFECTIVE OVERSIGHT, BUT OPPORTUNITIES TO IMPROVE EFFICIENCY EXIST (2020) (documenting the relative size of the SEC and FINRA teams).
46 SECURITIES AND EXCHANGE COMMISSION, FISCAL YEAR 2021 BUDGET JUSTIFICATION AND ANNUAL PERFORMANCE PLAN AND FISCAL YEAR 2019 ANNUAL PERFORMANCE REPORT 44.
47 As of 2019, more than 3,500 broker-dealer firms were registered with FINRA. FINANCIAL INDUSTRY REGULATORY AUTHORITY, FINRA INDUSTRY SNAPSHOT: A REPORT FROM THE FINANCIAL INDUSTRY REGULATORY AUTHORITY (2019) (documenting the number of broker-dealers registered with FINRA).
49 See SEC, Office of Compliance Inspections and Examinations, Examination Information for Entities Subject to Examination or Inspection by the Commission (June 2014), at 4 (noting that FINRA can be a source of referrals). FINRA also can, and frequently does, make referrals to federal and state enforcement authorities, and publicly tracks the results of those referrals on its website. FINANCIAL INDUSTRY REGULATORY AUTHORITY, ACTIONS RESULTING FROM REFERRALS TO FEDERAL AND STATE AUTHORITIES (2020) (listing SEC enforcement actions resulting from FINRA referrals).
Findings during FINRA inspections can lead to serious consequences. FINRA has the authority to take disciplinary action against brokers including fines, suspensions, or a bar from the securities industry. In 2019, FINRA barred 348 individuals, suspended another 415, and referred 827 cases related to fraud or insider trading to criminal authorities.

FINRA also oversees an extensive arbitration program that allows customers to bring complaints against their brokers. In 2019 alone, FINRA’s Complaint Program received more than 2,900 customer complaints regarding broker conduct, some of which FINRA supplemented by imposing formal sanctions. The relatively low cost of arbitration through this system is thought to induce a greater number of complaints, as clients are presumably willing to arbitrate disputes that would be too expensive to litigate in the normal court system.

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50 See, e.g., FINRA, ENFORCEMENT PRIORITIES (2020) (“Sanctions [that FINRA may impose] for wrongdoing include fines, suspensions, and, in cases of serious misconduct, bars from the brokerage industry.”).

51 FINANCIAL INDUSTRY REGULATORY AUTHORITY, supra note 37, at 14.

52 For a detailed institutional description of the FINRA arbitration program, and the effects of permitting registered representatives to remove, or “expunge,” customer complaints from their BrokerCheck records, see Honigsberg & Jacob, supra note 20, at 4. For historical perspective on the emergence and evolution of FINRA’s arbitration program over the past three decades, see Seth E. Lipner, The Expungement of Customer Complaint CRD Information Following the Settlement of a FINRA Arbitration, 19 FORDHAM J. CORP. & FIN. LAW 57 (2013).

53 See FINANCIAL INDUSTRY REGULATORY AUTHORITY, supra note 37.

54 For small claims up to $10,000, filing fees will not exceed $325. See FINANCIAL INDUSTRY REGULATORY AUTHORITY, FINRA RULEBOOK, Rules 12900, 13900 (2018). Claimants may also elect whether to have counsel. See id.
Finally, because brokerage firms are responsible for sponsoring individual representatives, they act as private regulators in disciplining bad brokers. For example, recent research shows that around 11% of disclosures in the BrokerCheck system involve firings after allegations of misconduct, and around half of brokers lose their jobs after misconduct.55

B. Regulation of Investment-Adviser Representatives

In addition to, or instead of, being licensed as a FINRA registered representative, financial advisors are often representatives at investment adviser firms.56 Although investment adviser57 representatives differ from broker-dealers in that they often provide ongoing advice and wealth management, whereas brokers usually receive transaction-based compensation, the more significant differences are related to regulatory oversight. Like broker-dealers, investment advisers are also sponsored by the firm that employs them for registration with the SEC.

But investment advisers are governed by a separate statute, the Investment Advisers Act of 1940, and separate SEC rules promulgated under that law. Those rules require investment adviser representatives

55 See Egan et. al, supra note 10, at 4.
57 In light of the nomenclature in the statute itself, investment advisors (and their individual representatives) regulated under the Investment Advisers Act have historically been referred to with that spelling, whereas the term advisor is used for professionals who offer financial advice more generally. This one-letter difference has been the subject of considerable consternation at the SEC. Compare Mark Schoeff Jr., Is Title Reform the Answer to the Fiduciary Debate?, INVESTMENTNEWS (March 10, 2018) (noting that a 2018 SEC proposal suggested the Commission may “reform” the use of titles in this way) with Greg Iacurci, The SEC Botched Title Reform, INVESTMENTNEWS (Sept. 11, 2019).
either to register with the SEC or the state in which the adviser maintains its principal place of business. As of 2019, there were 425,771 active investment adviser representatives. In this Article, borrowing from practitioners’ parlance, we refer to these individuals as ‘40 Act advisers.

The Investment Advisers Act of 1940 imposes fiduciary duties on advisers. Under this regime, ‘40 Act advisers are required to prioritize their clients’ interests and to disclose any potential conflicts of interest. Investment advisers are also required to file disclosures with the SEC on what is known as Form ADV. ‘40 Act advisers who file Form ADV provide information similar to that collected on Form U-4 for FINRA brokers. Form ADV describes the individual’s professional background and conduct, employment history, conflicts of interest, and any disciplinary events. ‘40 Act Advisers are also required to provide

59 At the firm level, more than 13,500 investment adviser firms managing more than $84 trillion in client assets were registered with the SEC, with another 15,000 registered with state regulators. SECURITIES AND EXCHANGE COMMISSION, supra note 46, at 14 (documenting these magnitudes in connection with the SEC’s most recent budget request). Notwithstanding the SEC’s resource limitations in connection with this work, research suggests that SEC oversight of investment advisers is significantly more strenuous than that of state regulators. See, e.g., Ben Charoenwong, Alan Kwan & Tarik Umar, Does Regulatory Jurisdiction Affect the Quality of Investment-Adviser Regulation?, 109 AM. ECON. REV. 3681 (2019).
60 Although the SEC recently reinterpreted the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1, in a fashion that appears to weaken that duty, the effects of that change on the conduct of ‘40 Act advisers remains to be seen. See Jackson, supra note 40 (dissenting from the SEC’s new interpretation of the Investment Advisers Act).
61 For a detailed description of Form ADV and its history and purpose, see SECURITIES AND EXCHANGE COMMISSION, DIVISION OF INVESTMENT MANAGEMENT, FORM ADV GLOSSARY OF TERMS (2012). For firms, Form ADV includes information on an advisory firm’s types of clients, advisory services provided, the structure of the adviser’s compensation, and any disciplinary history for the adviser or key personnel.
summary disclosures in plain-English brochures to potential clients that contain much of the same information in a more easily accessible form.

To aid investors in finding a ’40 Act adviser, the SEC makes available a searchable database of ADV information on a section of its website known as Investment Adviser Public Disclosure (IAPD). Until recently, limitations on the IAPD website made it difficult to access certain historical information; however, the SEC has since contracted with FINRA to operate IAPD, leading to several upgrades to IAPD.62 Despite the similarities of BrokerCheck and IAPD, recent empirical work has shown that BrokerCheck enjoys far more web traffic.63

Private policing of ’40 Act adviser misconduct is much more limited than in the FINRA regime. Firms play a role as intermediators, but there is no private right of action and no SEC-sponsored arbitration system.64 Instead, the ’40 Act adviser regime relies largely on SEC

62 Following a 2015 recommendation from the SEC’s Investor Advisory Committee (IAC) to “reduce the complexity of background searches” on the BrokerCheck and IAPD systems, Securities and Exchange Commission Investor Advisory Committee, Recommendation on Background Check on the Financial Markets (2015), in 2020 the SEC and FINRA took steps to ensure that data were available from both resources in the same file format, a change that made the data extraction undertaken for this Article more straightforward. See Securities and Exchange Commission, Release No. 34-88760, File No. SR-FINRA-2020-012, Financial Industry Regulatory Authority, Inc., Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend FINRA Rule 8312 to Allow the Dissemination of IAPD through Brokercheck (2020).

63 See Honigsberg & Jacob, supra note 20, at 14.

64 See Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 19 (1979) (holding that, although the Investment Advisers Act contemplates the voiding of certain types of agreements, “the mere fact that the statute was designed to protect advisers’ clients does not require the implication of a private cause of action for damages on their behalf,” and hence, the Act does not confer a private right of action).
examinations and enforcement. Investment-adviser oversight is conducted largely by the SEC’s Office of Compliance, Examinations and Inspections (“OCIE”).65 Although OCIE inspected more than 3,000 investment advisers in 2019, that figure amounts to just 17% of the advisers registered with the SEC, and even that level of inspection is a marked increase from previous years, in which OCIE examined fewer than 10% of the firms it supervises.66 By contrast, recall that FINRA inspected roughly half of broker-dealer firms in that same year.67 The frequency of inspections is important, as these inspections can uncover malfeasance and raise issues leading to severe consequences for firms and individuals.68

65 In December 2020, the SEC announced that OCIE had been renamed, and henceforth will be known as the Division of Examinations, see SEC, Statement on the Renaming of the Office of Compliance Inspections and Examinations (Dec. 17, 2020). For ease of exposition, throughout this Article we refer to the Division by its historical appellation: OCIE.

66 See, e.g., Commissioner Elisse Walter, Statement on Study on Enhancing Investment Adviser Examinations (January 2011) (describing the SEC’s investment-adviser oversight “resource problem [as] severe.”).

67 The possibility of providing self-regulatory organizations like FINRA with enforcement authority over investment advisers has been repeatedly raised by policymakers for some time, but lawmakers have not yet taken the steps necessary to give FINRA that authority. See, e.g., id. (suggesting that self-regulatory oversight for investment advisers may be appropriate in light of the SEC’s resource limitations).

68 OCIE inspections can, and often do, result in a range of consequences for the firm, ranging from a letter identifying problems that the adviser must resolve (known as a “deficiency letter”) to a referral to the SEC’s Division of Enforcement for potential litigation. In 2020, more than half of OCIE examinations identified at least one deficiency, see SEC, OFFICE OF COMPLIANCE, INSPECTIONS AND EXAMINATIONS, Risk Alert, Observations from OCIE’s Examinations of Investment Advisers: Supervision, Compliance, and Multiple Branch Offices (Nov. 9, 2020), at 3 (“[t]he vast majority of the examined advisers were cited for at least one deficiency related to [the maintenance of] compliance policies and procedures”), and in 2019 more than 5% of inspections resulted
C. State Regulation of Insurance Producers

Firms and professionals offering financial advice may also be registered with state insurance regulators. State-level licensing and registration is required for those that sell insurance—known as insurance “producers.” As of 2020, 2.58 million individuals, and 222,467 business entities, were licensed to provide insurance services in the United States. Although it may be counterintuitive to think of insurance producers as financial advisors, as we explain in this section insurance professionals across the Nation can, and frequently do, provide financial advice.

To see why, note that many popular insurance products, such as indexed and variable annuities, are linked to the value of securities. These products offer the insured payouts that depend on the performance of an underlying basket of investments, raising similar questions—and presenting similar risks—as those raised by investment advice more generally. Indeed, for that reason the SEC itself pursued rules that would

in referrals to the SEC’s Division of Enforcement, see SEC, OFFICE OF COMPLIANCE, INSPECTIONS AND EXAMINATIONS, Examination Priorities (2019), at 3.

69 Insurance producers are also known colloquially as “insurance agents” or “insurance brokers”; the use of those terms varies by jurisdiction. See, e.g., Kevin Knauss, Insurance Agent, Broker, Producer: What Are the Differences? (Feb. 27, 2020) (noting the differences, under California law, among terminology for an insurance broker, CAL. INS. CODE § 1623 (2018), and an insurance agency, Cal. Ins. Code § 1621 (2018)).

70 See Email from Will McDermott, National Association of Insurance Commissioners, to Colleen Honigsberg (Oct. 8, 2020, 4:14 EST) (on file with authors).

71 In an effort to protect consumers who purchase such products, and recognizing the overlap between insurance products and investment advice, the SEC’s investor-education resources dedicate significant space to variable annuities. See SEC, INVESTOR.GOV: VARIABLE ANNUITIES (“Variable annuities involve investment risks just

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have regulated indexed annuities as securities, noting the Commission’s concern that investors may not receive sufficient protections in connection with the sale of those products. However, extensive insurance-industry lobbying ensured that most indexed annuities would not be regulated as securities.\textsuperscript{72} Nonetheless, the overlap among financial advisors and insurance producers is substantial: as of 2017, some 39.5% of all retail broker dealers were engaged in the sale of life insurance or annuities.\textsuperscript{73}

Individual insurance producers usually register with the state in which they are located—but, because they often operate in multiple states, the median insurance producer in our sample\textsuperscript{74} is licensed in two states.\textsuperscript{75}

like mutual funds do. If the investment choices you selected for the variable annuity perform poorly, you could lose money.\textsuperscript{”) (last accessed January 16, 2020).}

\textsuperscript{72} See SEC, Final Rule: Indexed Annuities and Certain Other Insurance Contracts, Release Nos. 33-8996, 34-59221 (2010), at 100-102 (firmly rejecting insurance-industry objections to this rule, including that “the purchaser of an indexed annuity does not assume investment risk. We disagree.”). In response, insurance advocates persuaded Congress to amend federal law to explicitly provide that fixed-index annuities are exempt from securities regulation. See Section 989J, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-123, 124 Stat. 1376 (2010); SEC, INVESTOR EDUCATION: ANNUITIES (2020) (“most indexed annuities are not registered with the SEC”) see also Sheryl J. Moore, Indexed Annuities’ Battle with SEC Comes to an End, ANNUITY SPECS: THE INDEXED EXPERTS (July 21, 2010) (noting that the inclusion of this provision reflected the end of “a long and hard-fought battle with securities regulators,” which was “finally won by the insurance industry.”).

\textsuperscript{73} See SEC, Final Rule: Regulation Best Interest, supra note 9, at 229 (providing data to the effect that “broker-dealers’ most significant business lines include . . . acting as a broker or dealer selling variable contracts, such as life insurance or annuities”).

\textsuperscript{74} See infra text accompanying notes 95-99 (describing our dataset and summary statistics on insurance activity).

\textsuperscript{75} Some, but not all, states provide insurance producers with “reciprocity”: recognition by State A that licensure in State B is sufficient to sell insurance in State A. Efforts to promote reciprocity and standardization in state-level insurance regulation

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Unlike FINRA brokers or ’40 Act advisors, insurance producers rarely associate with a single firm; instead, they maintain relationships with a wide range of insurance companies. Thus, insurance producers, unlike FINRA brokers or ’40 Act advisors, do not rely on a single firm for sponsorship, licensing, or registration—meaning that, in most cases, no single company is responsible for an insurance producer’s conduct.\textsuperscript{76}

Also unlike FINRA brokers and ’40 Act advisors, insurance producers are not subject to the oversight of a single federal regulator.\textsuperscript{77} Instead, state insurance commissioners coordinate to draft model laws through a private non-profit, the National Association of Insurance

\textsuperscript{76} See, e.g., Jennifer Brown & Dylan Minor, Misconduct in Financial Services: Differences Across Organizations (Harvard Business Sch. Working Paper No. 16-022), at 10-11 (documenting that, while some insurance companies work only with exclusive producers that sell only that insurer’s products, a substantial proportion of producers are “independent agents [who] are not affiliated with any single insurance company”).

\textsuperscript{77} See NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, REVISIONS AND CLARIFICATIONS TO THE UNIFORM LICENSING STANDARDS 4 (2011). In general, individuals must pass an exam and background check to obtain a license, see id. at 14. While licensing requirements vary considerably across the fifty states and the District of Columbia, state-level licenses typically cover a specific category, or “line,” of insurance.
Commissioners (NAIC). NAIC model laws are very influential\(^{78}\) and widely adopted by state legislatures.\(^{79}\) The NAIC has also suggested standards for insurance producer conduct that mirror the standards that apply to FINRA brokers.\(^{80}\) But—unlike in the FINRA regime—there is no private arbitration mechanism for enforcing these standards.

Instead, insurance producer conduct is overseen entirely by the states—to varying degrees of success. While most states have adopted the NAIC’s model standards for analysis, investigations, and exams, survey evidence suggests that there remain significant deficiencies due to a lack of uniformity in enforcement.\(^{81}\) For example, the frequency of regulatory actions varies widely, with some states taking action against as many as

\(^{78}\) Some observers have worried that this unusual arrangement raises constitutional concerns. See, e.g., Daniel Schwarcz, Is U.S. Insurance Regulation Unconstitutional?, 25 CONN. INS. L.J. 191 (2018).

\(^{79}\) For example, a majority of states have adopted the NAIC’s Model Producer Licensing Act, which governs standards for producer registration and licensing. See National Association of Insurance Commissioners, Model Laws, Regulations, Guidelines and Other Resources (2005).

\(^{80}\) See NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, CENTER FOR INSURANCE POLICY AND RESEARCH (Nov. 11, 2020). After the SEC adopted recent new standards on broker conduct, see SEC, Final Rule: Regulation Best Interest, supra note 9, the NAIC approved its own, similar standard in February 2020, but as of November 2020 only three States—Arizona, Iowa, and Rhode Island—have adopted those changes. Other states, such as New York and Massachusetts, have instead chosen to adopt more stringent standards for insurance-producer conduct. N.Y. INS. L. § 2120 (McKinney 2018).

\(^{81}\) See e.g., U.S. DEPARTMENT OF THE TREASURY, HOW TO MODERNIZE AND IMPROVE THE SYSTEM OF INSURANCE REGULATION IN THE UNITED STATES 53 (2013) (describing survey results indicating that 78% of participants cite a lack of uniformity in state approaches to oversight as a reason market-conduct practices need improvement).
one out of 100 registered insurance producers each year and others taking action against as few as one out of 1,000.82

There is also no consumer-oriented, centralized website containing insurance producers’ misconduct records. Unlike FINRA brokers (whose misconduct is disclosed on BrokerCheck) or ’40 Act advisers (reported on IAPD), insurance producers face little risk of prominent public disclosure of their misconduct.83

Instead, consumers seeking information on a state-licensed insurance salesperson must typically search each state’s database, and there is considerable variation in the type and quantity of information made available to consumers in each jurisdiction. Relatively few states allow consumers to identify advisor-level misconduct through these

See, e.g., DANIEL SCHWARCZ & PETER SIEGELMAN, RESEARCH HANDBOOK ON THE ECONOMICS OF INSURANCE LAW 44 & fig. 4 (2017).

The closest parallel is the National Insurance Producer Registry (NIPR), a nonprofit, national registry of insurance producers. But the NIPR is producer-focused rather than consumer-focused; while it offers a wide range of services for producers, it does not provide background information on these individuals akin to the information provided on BrokerCheck and IAPD. To be sure, NAIC provides three sources of centralized, online information that may be useful to consumers—but none provides comprehensive data on individual producers’ misconduct records. First, an NAIC website directs consumers with complaints to the particular state websites where such complaints can be submitted. Second, NAIC produces reports, combining data from more than fifty jurisdictions, on the disposition of consumer complaints by complaint type. Finally, an NAIC online tool allows consumers to search for insurance companies (as opposed to individual producers) and obtain reports related to misconduct complaints against that company. While NAIC does have searchable databases of further, individual-level data about complaints and regulatory actions known as the Regulatory Information Retrieval System (RIRS) and Special Activities Database (SAD), by their terms those databases are currently searchable only by insurance companies and state regulators. See Securities and Exchange Commission Investor Advisory Committee, supra note 62, at 14.
databases, and those that do make that process far more burdensome than a search of BrokerCheck or IAPD. And, unlike BrokerCheck and IAPD, even the few states that report regulatory misconduct do not necessarily report customer complaints against individuals.

D. Regulation of Commodity and Futures Dealers

Finally, financial advisors may be regulated by the Commodity Futures Trading Commission (CFTC). Under the Commodity Exchange Act, firms and individuals in the derivatives industry are required to register with the CFTC; and because the Advisers Act exempts those registered with the CFTC if their business does not “primarily” consist of activities under the SEC’s supervision, they may serve as advisors under the CFTC’s institutional framework. The CFTC regime features minimal regulation of substantive conduct, instead favoring a disclosure-based “know-your-customer” approach on the view that market participants in this area are more sophisticated than those in the securities regime.

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84 Recent work, for example, identifies the difficulty in obtaining and using public complaint data from the Texas Department of Insurance, particularly noting the limited distinctions among insurance products in that database. See Brown & Minor, supra note 76; see also Daniel Schwarcz, Transparently Opaque: Understanding the Lack of Transparency in Insurance Consumer Protection, 61 UCLA L. REV. 394 (2014). To our knowledge, only three States report insurance-producer misconduct in the standard license-search database, and only Texas provides complaints at the individual level, see TEXAS DEPT. OF INS. INTERNET COMPLAINTS INFORMATION SYSTEMS (2020) (citing TEX. INS. CODE § 843.282 (2018)).

85 See Commodities Exchange Act, 7 U.S.C. § 1 et. seq.

86 See, e.g., SECURITIES AND EXCHANGE COMMISSION & COMMODITY FUTURES TRADING COMMISSION, JOINT REPORT OF THE SEC AND CFTC ON HARMONIZATION OF REGULATION (2009), at 8, 77 (“the CFTC requires financial advisers to determine an appropriate level of disclosure particularized to the client based on the ‘know your customer’ information they have obtained … This approach to suitability is generally
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Since nearly all those registered with the CFTC must also be registered with the industry’s self-regulatory organization, the National Futures Association, we refer to these individuals as “NFA members.” More than 4,000 firms and 55,000 individuals were registered with the NFA as of 2019.87

Like FINRA and the SEC, the NFA attempts to facilitate private monitoring by providing a consumer-facing, publicly searchable website. This system, the Background Affiliation Status Information Center (“BASIC”), includes CFTC registration information, CFTC and NFA regulatory actions, customer complaints, and information about arbitration cases involving disputes between NFA members and customers.88 Unlike BrokerCheck or IAPD, however, BASIC does not include information on criminal proceedings, actions taken by other federal and state regulatory agencies, or financial disclosures.89

Individuals associated with CFTC-regulated firms are subject to inspections and examinations by both the CFTC’s Division of Swap premised on the notion that, once customers in the futures industry receive an appropriately tailored disclosure stating that all futures are risky and volatile instruments, they subsequently are in the best position to determine the propriety of a particular futures trade.”); see also NATIONAL FUTURES ASSOCIATION, COMPLIANCE RULE 2-30: CUSTOMER INFORMATION AND RISK DISCLOSURE.

87 NATIONAL FUTURES ASSOCIATION, ANNUAL REVIEW 15 (2019)
88 See NATIONAL FUTURES ASSOCIATION, NATIONAL FUTURES ASSOCIATION BACKGROUND AFFILIATION STATUS INFORMATION CENTER TERMS OF USE (2020).
89 See NATIONAL FUTURES ASSOCIATION, supra note 87, at 10 (noting the NFA’s ongoing consideration of whether to add further details to the BASIC system, and pointing out that, in 2019, there were 200,000 BASIC searches each month).
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Dealer and Intermediary Oversight (DSIO) and the NFA. Firms that fail to remediate issues identified in inspections may be referred to enforcement staff at either the CFTC or NFA, which can investigate and adjudicate allegations of wrongdoing. In 2019, the NFA’s enforcement processes resulted in complaints against 37 individuals, resulting in five expulsions and six suspensions from the commodity-dealing business; during the same period, the CFTC itself filed 69 enforcement actions.

As we have explained, the widely varying institutional settings—differing legal authority, enforcement intensity, standards of conduct, and efforts to facilitate private monitoring—gives financial advisors strong reason to wander among these regimes. In the next Part, we provide the first evidence of wandering financial advisors—and the implications of that phenomenon for lawmakers and investors.

III. Evidence on Wandering Financial Advisors

In this Part, we combine evidence from four institutional contexts in which financial advisors do their work to consider whether, and how,

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90 DSIO’s limited resources—as of 2019, about 75 employees and an inspection budget of just $23.1 million—mean that many inspections are, in practice, conducted by the NFA. See Commodity Futures Trading Commission, Matthew Kulkin, Dir., Division of Swap Dealer & Intermediary Oversight, Remarks at New York City Bar Association (May 14, 2019).

91 For helpful description of the NFA’s process for determining whether and when to refer issues identified during inspections to NFA or CFTC enforcement personnel, see Commodity Futures Trading Commission Division of Clearing and Intermediary Oversight, Review of the Disciplinary Program of the National Futures Association (July 2002), at 15.

advisors wander among regulatory regimes. We begin with a description of our dataset, and then turn to our principal findings. We show that wandering is widespread, and that wandering advisors have higher rates of misconduct and recidivism. Finally, we provide striking evidence that wandering advisors pose a unique threat to state insurance regimes.

A. Financial Advisor Record Extraction

Our analysis relies on data extracted from four sources, each of which offers information on financial advisors working in a distinct institutional context. We combine data from FINRA’s BrokerCheck, which provides data on FINRA brokers; the SEC’s IAPD, which covers ’40 Act advisers; state insurance regulator databases, which provide detail on insurance producers; and evidence from NFA’s BASIC system, which provides detailed information on NFA members, to examine a broad landscape of financial advisors’ work.

We assembled the dataset in four steps. First, we scraped FINRA’s BrokerCheck, which contains information on all individuals who have been registered representatives of broker-dealers at any point in the past ten years, obtaining records on some 1.2 million brokers.93 Using the detailed disciplinary history available in BrokerCheck, we determine whether a broker has a record of “misconduct” or “serious misconduct.”94

93 With limited exceptions, BrokerCheck maintains records for all individuals who were actively registered with FINRA at any point in the past ten years. See, e.g., Qureshi and Sokobin, supra note 43, for a history of BrokerCheck. We scraped BrokerCheck in July 2020; thus, many of the 1.2 million unique brokers are not currently active, but were active at some point from June 2010 through June 2020.

94 Following prior literature in this area, see, e.g., Egan et al., supra 10, we identify a broker as having had misconduct if that individual has paid to settle customer disputes, has been terminated by an employer after allegations of improper behavior, has received criminal or regulatory sanctions, or has been held civilly liable in white collar
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The subset of “serious misconduct” includes only criminal or regulatory infractions, civil judgments, and employer terminations after allegations of improper conduct.95

Next, we extract data on ’40 Act advisers from the SEC’s IAPD website. This site is similar in structure to BrokerCheck. We extract information on just under 570,000 advisers, including data on advisor misconduct.96

Third, we assembled data on insurance producers by contacting each state’s insurance department. Where we could, we downloaded publicly available data from state websites; if no public data were available, we filed public records requests, supplementing any missing data by scraping state websites or the NAIC’s State Based System.97 Using this process, we identified just over 2.3 million registered insurance

 litigation. Because regulatory actions can take years to investigate or decide—and thus be categorized as “final”—we include final regulatory events that are disclosed up to two years after leaving a firm.

95 We are grateful to Jonathan Sokobin and Matthew Kozora for their helpful suggestions with respect to defining and identifying degrees of broker misconduct. Because some indicators of misconduct, such as consumer complaints, are thought to be correlated with product complexity, our definition of “serious misconduct” reflects our attempt to standardize misconduct rates across products.

96 Like BrokerCheck, IAPD maintains records for individuals who have been active at any time in the past ten years. We scraped IAPD in July 2020, so our data include advisors who were active at some point from June 2010 through June 2020.

97 NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, STATE BASED SYSTEMS (2020) (providing information from state insurance regulators). Unlike FINRA BrokerCheck or the SEC’s IAPD website, state insurance-producer data includes only individuals who are currently registered with the relevant regulator. Thus, we do not have historical data, meaning we lack information on those individuals who were previously licensed producers but exited the insurance regime before we obtained our data.
producers.98 Because the NAIC reports that there are 2,576,012 currently registered insurance producers nationwide, our sample represents roughly ninety percent of active insurance producers. The data include name, address, lines of authority, state of registration, registration start date, registration expiration date, license number, and a unique identifier that is commonly used across states to identify individual producers.99

Finally, we obtain information on National Futures Association members by scraping the NFA’s BASIC website. Like BrokerCheck and IAPD, the NFA’s BASIC website reports prior employment history and qualifications for all registered individuals. But while BASIC provides individual-level misconduct, the information is more limited.100 Our...

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98 We received data on registered insurance producers from 36 states, including major markets for financial advisors such as New York, Texas, Ohio, and Florida. We did not receive data from a few states for idiosyncratic reasons (for example, Tennessee denied our records request because none of us is a Tennessee resident). Because it is common for insurance producers to register in more one state, our final sample includes individuals who are not located in any of the 36 states for which we received data.

99 The identifier is referred to as a National Producer Number, or NPN. If the data we received from the state did not contain this information, we used the partial information we did obtain to scrape the state’s website or the NAIC’s State Based System (“SBS”). Of the 25 states and territories that have information on the SBS, only a subset of these states and territories provide searchable registration data. Given the significant fragmentation of registration information and the occasionally sparse use of NPNs in some states, scraping NAIC using the same method as BrokerCheck is not practical. Extracting data on misconduct, too, presented a number of hurdles. For example, only a handful of states provide misconduct in a machine-readable format. Thus, although we obtained misconduct data for 13 states through a combination of hand-collection and public-records requests, the misconduct includes only regulatory actions and is limited to a small number of states.

100 Unless the incident went through arbitration, customer disputes are generally not reported in BASIC. Further, only regulatory actions from the NFA, CFTC, and exchanges are reported.
sample includes just over 270,000 unique NFA members.

B. Dataset Assembly

As noted above, BrokerCheck provides the most comprehensive data among the four institutional contexts we study. Thus, our analysis follows the career paths of those who exit the FINRA broker-dealer regime while continuing to provide financial advice in another context.

We begin with the full sample of individuals who appear in BrokerCheck for any year from 2010 to 2020. We match these individuals to the data described above from IAPD, state insurance regulators, and NFA’s BASIC. This approach allows us to match individuals who appear in BrokerCheck with their current registration status as a ’40 Act advisor, an insurance producer, or an NFA member.

The ease of combining BrokerCheck with each of these three data sources varies considerably. Both BrokerCheck and IAPD, for example, identify advisors using a common identifier, making merging the data straightforward. By contrast, neither state insurance regulators nor BASIC identify individuals using this same identifier.

Thus, we use an algorithm to match individuals from BrokerCheck with those in our insurance-producer and NFA datasets. We first perform a fuzzy match based on first name, last name, and state, and then disambiguate matches using middle name, suffix, city, and ZIP code. To

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101 The identifier is a unique, eight-digit number known as a Central Registration Depository (CRD) number. See Financial Industry Regulatory Authority, Central Registration Depository (2020).

102 The fuzzy-match procedure we use produces a match score between 0 and 1. The median match score in our sample is .95, consistent with a high accuracy rate.
confirm that our match was accurate, we hand-checked a random sample of matches. This check yielded only a 2% error rate, suggesting that our algorithm has high accuracy.

C. Evidence on Wandering Financial Advisors

In this section, we exploit this unique dataset to empirically examine wandering among financial advisors. We first provide evidence that wandering is widespread. Next, we show that wandering advisors have high rates of misconduct during their time as FINRA brokers, and that wanderers with a history of misconduct have elevated rates of recidivism after exiting the FINRA broker regime relative to those with misconduct who remain. Finally, we show, brokers with misconduct are particularly likely to gravitate to the state insurance regimes.

1. Frequency of wandering and misconduct rates. We begin with summary statistics on registration status for advisors in our sample. For the advisors who are currently registered with one or more of the four regulatory regimes we examine, Table I below reports their latest registration status and the percentage of those advisors with one or more incidences of misconduct or serious misconduct:

<table>
<thead>
<tr>
<th>Number of Registered Individuals</th>
<th>Observations</th>
<th>Serious Misconduct</th>
<th>Misconduct</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broker Registered with FINRA</td>
<td>1,069,125</td>
<td>4.63%</td>
<td>7.35%</td>
</tr>
<tr>
<td>Adviser Registered with SEC</td>
<td>531,509</td>
<td>5.21%</td>
<td>9.88%</td>
</tr>
<tr>
<td>Insurance Producer</td>
<td>233,208</td>
<td>6.48%</td>
<td>12.61%</td>
</tr>
<tr>
<td>NFA Member</td>
<td>16,908</td>
<td>5.45%</td>
<td>15.39%</td>
</tr>
</tbody>
</table>

**Table I Registration Status and Misconduct Rates for Individuals in Our Sample**
As Table I shows, in total our data identify 1,202,952 financial advisors registered with FINRA during our sample period. Roughly 89% of these individuals are currently registered with FINRA, 44% are registered as ’40 Act advisers, 19% as insurance producers, and 1.4% as NFA members.103 Consistent with prior work, our data show that those who are registered in more than one regime have higher rates of misconduct.104

Next, we consider summary statistics on the individuals who exit the FINRA broker regime in Table II below:

<table>
<thead>
<tr>
<th></th>
<th>Observations</th>
<th>Serious Misconduct</th>
<th>Misconduct</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total who Exited BrokerCheck</td>
<td>395,887</td>
<td>5.68%</td>
<td>6.99%</td>
</tr>
<tr>
<td>Number of Wandering Advisors</td>
<td>133,827</td>
<td>7.81%</td>
<td>10.71%</td>
</tr>
<tr>
<td>’40 Act Adviser</td>
<td>90,740</td>
<td>5.80%</td>
<td>8.14%</td>
</tr>
<tr>
<td>Insurance Producer</td>
<td>50,777</td>
<td>11.89%</td>
<td>16.17%</td>
</tr>
<tr>
<td>NFA Member</td>
<td>1,347</td>
<td>13.44%</td>
<td>16.85%</td>
</tr>
</tbody>
</table>

**TABLE II. REGISTRATION STATUS AND MISCONDUCT RATES FOR INDIVIDUALS WHO LEFT BROKERCHECK**

As Table II shows, 395,887 individuals exited BrokerCheck during the decade we study here, with 133,827 remaining registered in another regime. We identify these 133,827 individuals as “wandering advisers”:

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103 As noted above, see supra note 85, it is common for a financial advisor to be simultaneously registered with more than one regime.

those who do not maintain their FINRA broker status but continue to provide financial advice in another regime.

Table II shows that wandering advisors are common: about 34% of those who exit BrokerCheck continue providing financial advice. It is most common for those individuals to remain ’40 Act advisers; still, over 50,000 continue working as state insurance producers, with just 1,500 remaining registered NFA members.

Table II also illustrates that the frequency of both misconduct and serious misconduct among wandering advisors is striking relative to their peers. For example, Table I shows that 4.63% of FINRA brokers have serious misconduct in their records, with 7.35% having any history of misconduct. But Table II shows those figures are far higher among wandering advisors: 7.81% have serious misconduct and 10.71% have some history of misconduct. Misconduct rates are most pronounced among those who exit the BrokerCheck regime but continue working as insurance producers: some 13.44% of those individuals have a history of serious misconduct, and 16.85% have a history of any misconduct.

In short, the baseline rates of misconduct and serious misconduct among all FINRA brokers more than double for those who wander away from the FINRA regime but continue providing financial advice as insurance brokers and NFA members. These trends are concerning, as they suggest that “bad” advisors in the FINRA broker regime exit but continue to provide consumer financial services. In particular, the data show, many become insurance producers.

What’s more, wandering advisors have more reports of serious misconduct generally than their peers who remain registered as FINRA brokers. Figure 1 below describes the percentages of FINRA brokers and wandering advisors, respectively, with a given number of serious-misconduct disclosures in our dataset:
Wandering Financial Advisors

Figure 1 presents the percentage of advisors with each number of serious misconduct disclosures, conditional on whether the individual is a wandering advisor. For example, wandering advisors are more than twice as likely to have two reports of serious misconduct in our databases. On balance, our data show that wandering advisors are much more likely to be recidivists compared to advisors who remain subject to FINRA’s oversight.

2. **Wandering advisors and recidivism.** Of course, the mere fact that wandering advisers have higher levels of past misconduct does not necessarily mean that they are more likely to harm investors in the future. And the analysis in Part III.C.1. above reflects only the total number of misconduct disclosures received over an advisor’s career, not annualized rates of misconduct. For example, a broker may leave for the insurance regime because they are barred from the securities industry, or because they merely prefer the flexibility of being their own boss. Therefore, it can
be instructive to look at rates of new misconduct for different types of wandering advisors.

Specifically, we consider the annual rates of new misconduct in Table III below. As before, we distinguish between those advisors with a past history of misconduct and those without—and compare the threat they pose to investors after they wander. Table III presents those rates for current FINRA brokers and wandering advisors, in each case conditional on whether the individual has a record of past misconduct.\(^{105}\)

<table>
<thead>
<tr>
<th>Classification</th>
<th>Serious Misconduct</th>
<th>Misconduct</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Current FINRA Brokers</td>
<td>0.36%</td>
<td>2.00%</td>
</tr>
<tr>
<td>Wandering Advisors</td>
<td>0.27%</td>
<td>2.59%</td>
</tr>
<tr>
<td>'40 Act Adviser</td>
<td>0.25%</td>
<td>2.32%</td>
</tr>
<tr>
<td>Insurance Producer</td>
<td>0.24%</td>
<td>2.64%</td>
</tr>
<tr>
<td>NFA Member</td>
<td>0.56%</td>
<td>3.47%</td>
</tr>
</tbody>
</table>

**Table III. Recidivism and Wandering Advisors**\(^{106}\)

\(^{105}\) For individuals who remain '40 Act advisers, we receive misconduct records in IAPD after they exit the FINRA regime. Those who remain registered with state insurance regulators or NFA members after exiting the FINRA regime are required to continue updating their misconduct records for two years, with further obligations if they have more disclosures during that two-year window. FINANCIAL INDUSTRY REGULATORY AUTHORITY, FORMERLY REGISTERED REPS (2020). Thus, to address potential sample selection bias, in unreported analysis we also examine statistics for former brokers in those regimes limited to that two-year reporting window and find similar trends.

\(^{106}\) In order to provide a clearer comparison, we calculate the percentages in Table III based on individuals with only the classification in question. For example, the line representing insurance producers includes only individuals who exited FINRA’s broker regime and remained state registered insurance producers, not those who remained state registered insurance producers and '40 Act advisers or NFA members.
This evidence deepens our understanding of the higher rates of misconduct we observe among wandering advisors. As Table III shows, wandering advisors with no history of misconduct have similar or even lower rates of misconduct than current FINRA brokers. By contrast, wandering advisors who already have a record of misconduct when they exit the FINRA regime are much more likely to reoffend than brokers currently registered with FINRA who also have a record of misconduct.

Consider, for example, a financial advisor who exits the FINRA regime but remains a registered insurance producer. Assuming that this advisor does not have a history of misconduct upon exiting BrokerCheck, she has a 0.24% chance of reporting misconduct in each year thereafter.\textsuperscript{107} By contrast, assuming that this individual already had a history of serious misconduct when she exited BrokerCheck, there is a 2.64% chance she will incur misconduct in each year thereafter.

In sum, Table III suggests that wandering advisors with no history of misconduct do not pose an additional threat to consumers. However, those wandering advisors who already have a history of misconduct when they leave the FINRA broker regime are far more likely to reoffend. Recidivism rates are especially high for those wandering advisors who continue to work as insurance producers or NFA members.

3. The unique role of insurance producers. The insurance industry appears to play a unique role in the story of wandering financial advisors. Although recidivism rates are high for both insurance producers and NFA members, less than 1,500 wandering advisors remain NFA members. Insurance producers, however, are far more common. Over 50,000 of our wandering advisors remain insurance producers.

\textsuperscript{107} In unreported tests, we show that this figure does not differ significantly from the baseline rate of 0.36% for those who remain FINRA brokers.
Further analysis reveals another concerning trend regarding insurance producers: relative to those without serious misconduct, individuals with serious misconduct are more likely to drop their status as a FINRA broker or '40 Act adviser— but less likely to drop their insurance license. This trend is shown in Table IV below, which includes only individuals who have changed their registration status and displays the percentage that have dropped or added a particular registration, conditional on whether the individual has serious misconduct:

<table>
<thead>
<tr>
<th></th>
<th>No Serious Misconduct (a)</th>
<th>Serious Misconduct (b)</th>
<th>Difference (b) – (a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drop Registration Status</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FINRA Broker</td>
<td>49.25%</td>
<td>64.04%</td>
<td>14.79%***</td>
</tr>
<tr>
<td>'40 Act Adviser</td>
<td>28.13%</td>
<td>36.09%</td>
<td>7.96%***</td>
</tr>
<tr>
<td>Insurance Producer</td>
<td>8.33%</td>
<td>5.85%</td>
<td>-2.48%***</td>
</tr>
<tr>
<td>NFA Member</td>
<td>3.73%</td>
<td>5.03%</td>
<td>1.30%</td>
</tr>
<tr>
<td>Add Registration Status</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FINRA Broker</td>
<td>2.56%</td>
<td>0.78%</td>
<td>-1.78%***</td>
</tr>
<tr>
<td>’40 Act Adviser</td>
<td>19.88%</td>
<td>8.75%</td>
<td>-11.13%***</td>
</tr>
<tr>
<td>Insurance Producer</td>
<td>8.83%</td>
<td>8.56%</td>
<td>-0.27%</td>
</tr>
<tr>
<td>NFA Member</td>
<td>0.80%</td>
<td>0.35%</td>
<td>-0.45%***</td>
</tr>
</tbody>
</table>

**Table IV. Outcomes for Brokers Who Change Registration**

108 Although the trend in Table IV suggests that individuals are also more likely to drop their status as an NFA member if they have serious misconduct, the reported t-tests show that the difference between the estimates described in Table IV is not statistically significant. Given that we have far fewer NFA members than any other type of financial advisor, the lack of significance may be due to limited statistical power.

109 The final column of Table IV reflects the difference between the percentages. *, **, and *** reflects that the difference is significant at 10%, 5%, and 1%, respectively.
Wandering Financial Advisors

Table IV also offers insights on how financial advisors *add* new registrations over time. Individuals with serious misconduct, Table IV shows, are less likely to become a FINRA broker, ’40 Act adviser, or an NFA member. And given that one purpose of licensing regimes is to prevent “bad actors” from being licensed while permitting the licensure of others, that trend makes sense. But there is no evidence that a history of serious misconduct makes it less likely that an individual will register as an insurance producer. In fact, among financial advisors who change registrations, some 8% of the advisors with serious misconduct manage to add a state insurance license despite their histories.

One concern with summary data is that there may be unobservable differences that make these trends misleading; for example, geographic or firm-level differences might explain what we see. To address those concerns, we examine the likelihood than an individual adds or drops a registration status conditional on serious misconduct through regression analysis. These regressions control for advisor characteristics\(^{110}\) and include a fixed effect for the advisor’s firm-county-year.\(^{111}\) The results from these regressions are consistent with our prior univariate analysis.

\(^{110}\) We control for years of experience, gender, and the number of qualifying exams the advisor has passed. We determine gender using GenderChecker.com. If the broker’s first name was not in our database or was unisex, we matched the middle name (or any other name excluding the broker’s last name).

\(^{111}\) This fixed effect accounts for potential differences across different firms and local economies, absorbing variation that can arise if, for example, some firms have affiliated insurance or SEC advisory businesses which make it easier for registered reps to be dual-registered or “switch.” This fixed effect also absorbs any common variation at the state-level that may influence the decision to change regulatory regimes (e.g., lax state securities or insurance oversight). Finally, the fixed effect absorbs any aggregate variation in regulatory status changes or misconduct (for example, spikes in misconduct investigated after the 2008 financial crisis). If the advisor’s firm is unknown, we consider the individual self-employed and create a unique firm fixed effect for that individual.
Wandering Financial Advisors

again suggesting that advisors with serious misconduct drop out of the FINRA regime and operate as state regulated insurance producers.112

Figure 2 below offers a visualization of the path financial advisors follow when they exit FINRA’s oversight regime:

Figure 2. Career Trajectories for Wandering Advisors

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112 Formally, in these regressions we consider the probability that individual \(i\), at firm \(j\), in county \(l\) leaves her firm in year \(t\) and changes her registration status at \(t+1\). Thus, we estimate the linear probability model

\[
Registration\ Status_{ijl,t+1} = \beta_0 + \beta_1 \text{Serious Misconduct}_{ijl,t} + \beta X_{ijl,t} + \mu_{ijl,t} + \varepsilon_{ijl,t},
\]

where the dependent variable \(Registration\ Status_{ijl,t+1}\) is one of four dummy variables indicating whether the advisor is registered with FINRA, the SEC, a state insurance regulator, or the NFA in year \(t+1\). Our main independent variable of interest \(Serious\ Misconduct_{ijl,t}\) is an indicator for whether an individual had a serious misconduct disclosure in year \(t\). \(X_{ijl}\) represents our vector of controls and \(\mu_{ijl}\) represents our fixed effect. For additional robustness, we replace the dependent variable with a dummy reflecting whether the advisor dropped a particular registration status. The results are consistent with those previously discussed. Although advisors with serious misconduct are more likely to exit both federal regimes than those without serious misconduct, this trend is reversed for state insurance producers.
Figure 2 divides wandering advisors into those with and without serious misconduct, documenting that, among individuals with a history of serious misconduct, the largest number flow into state insurance regimes. By contrast, among individuals with no such history, the largest number of those that exit FINRA oversight provide financial advice as ’40 Act advisors—subject to the SEC’s oversight.

4. Dual registrants. So far we have proceeded on the assumption that advisors wander by exiting the FINRA regime and affirmatively registering in a new jurisdiction. But in practice, it is common for individuals to be registered in more than one financial-advisory regime at one time. Hence, an advisor may wander simply by exiting the FINRA regime and maintaining her other license. In industry parlance, this is sometimes referred to as an advisor “dropping” her “broker hat.”

We consider which of these possibilities is the more common form of financial advisor wandering in Table V below:

<table>
<thead>
<tr>
<th>Conditional on Dropping FINRA Registration:</th>
<th>No Serious Misconduct (a)</th>
<th>Serious Misconduct (b)</th>
<th>Difference (b) – (a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Already ’40 Act Adviser</td>
<td>57.10%</td>
<td>63.88%</td>
<td>6.78% ***</td>
</tr>
<tr>
<td>Already Insurance Producer</td>
<td>61.26%</td>
<td>66.68%</td>
<td>5.42% ***</td>
</tr>
<tr>
<td>Already NFA Member</td>
<td>2.16%</td>
<td>2.59%</td>
<td>0.43%</td>
</tr>
<tr>
<td>Already Dually Registered</td>
<td>90.26%</td>
<td>93.82%</td>
<td>3.56 ***</td>
</tr>
</tbody>
</table>

**TABLE V. DUAL REGISTRATION FOR THOSE WHO DROP FINRA REGISTRATION**

Table V confirms that the most common form of financial-advisor wandering is “dropping a hat”—that is, the advisor is dually registered and, upon exiting the FINRA regime, maintains her other license. For
example, Table V shows, more than 60% of wandering advisors were state-licensed insurance producers at the time they dropped their FINRA registration—of those with serious misconduct, 66% were already insurance producers.

In sum, the evidence shows that wandering advisors with a history of misconduct are more likely to be recidivists in the future. Our data also show that, among wandering advisors, those with the most serious history of misconduct are disproportionately likely to end up in state insurance regimes. Finally, we have provided evidence that most wandering advisors are registered in multiple regimes before they exit FINRA oversight. These findings offer important implications for lawmakers concerned with the problems posed by wandering advisors. In the next Part, we consider those implications in detail.

IV. IMPLICATIONS FOR INVESTORS AND POLICYMAKERS

In this Part, we explore potential policy alternatives for lawmakers concerned about the costs wandering financial advisors may impose on investors who are increasingly reliant on financial advice. As explained below, our evidence suggests that these lawmakers should focus on improved regulatory coordination and better facilitation of firm-imposed discipline to address financial-advisor misconduct.

A. Regulatory Coordination and Accountability

Fragmented oversight of financial-advisor misconduct—featuring regulatory approaches with markedly different approaches to disclosing and deterring misconduct—gives advisors incentives to wander among regimes. Lawmakers concerned with the costs of wandering advisors’ misconduct should first focus on two changes to the regulatory landscape: a unified database of advisor misconduct and accountability among regulators responsible for overseeing advisors.
1. Unified database. The case for a single, searchable database of all individuals who provide financial advice in the United States is strong. This database should include FINRA brokers, ’40 Act advisers, insurance producers, and NFA members, as well as additional licensed professionals like mortgage brokers whose work may overlap with that of advisors.113

Such a database would benefit both regulators and consumers by significantly improving the ease and quality of monitoring advisors’ work. To see why, consider how difficult it is for an investor who is considering hiring a financial advisor to understand that individual’s history across regimes. Suppose, for example, that the investor is contemplating hiring an insurance producer and former FINRA broker named Jonathan Smith who lives in New York. A search of insurance producers licensed in New York will yield over twenty individuals with that name—and will contain no disciplinary history for any of them. A BrokerCheck search will provide disciplinary history, but it will require the investor to sift through more than twenty-five individuals named Jonathan Smith. And unless the investor has some other basis to know that Mr. Smith was previously a

113 Although some progress has recently been made in this regard, significant work remains. For example, FINRA and the SEC only recently agreed to integrate the BrokerCheck and IAPD databases, see supra note 62 (citing SEC, Release No. 34-88760, Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend FINRA Rule 8312 to Allow the Dissemination of IAPD through Brokercheck (2020)). The National Association of Insurance Commissioners and FINRA are also apparently working toward integrating their data on advisor misconduct, see NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, NATIONAL MEETING MATERIALS AND MINUTES (2019), at 5. In light of the frequency with which FINRA brokers with histories of serious misconduct wander to state insurance regimes, however, it is surprising that these efforts are at a relatively nascent stage.
FINRA broker, she would have no reason to search BrokerCheck at all.\textsuperscript{114} By placing registration and misconduct records online in a centralized database, regulators, consumers, journalists, and academics will be able to more easily monitor wandering advisors—and, importantly, reduce the benefits of wandering for those with a history of misconduct.

In light of the evidence in this Article that brokers who exit the FINRA regime after serious misconduct are far more likely to engage in misconduct in the future, we think this process is unnecessarily difficult. While the creation of a single, comprehensive database of financial advisors will require some coordination—and perhaps even Congressional intervention—the benefits of such a resource would be significant, giving both regulators and investors more information on the determinants of advisor misconduct. And because those benefits are increasing in the degree to which investors rely on financial advisors, we think the case for creating that resource is increasingly strong.

2. \textit{Regulatory accountability.} In light of financial advisors’ propensity for jurisdictional wandering, policymakers should also consider strengthening existing mechanisms for regulatory accountability. In particular, lawmakers should consider requiring regulators to track and disclose whether and how other jurisdictions make use of referrals related to advisor misconduct.

\textsuperscript{114} One might ask whether this resource would be more likely to be used by regulators or consumers to identify advisors likely to engage in misconduct. We acknowledge, of course, that there may be a limited degree to which individual investors can be expected to engage in the research necessary to select the most qualified advisor. We note, however, that consumers’ willingness to do so is endogenous to the difficulty of the task—which, as noted in the text, is unnecessarily challenging. In all events, we think regulators will find both the creation and availability of a national database exceptionally useful in identifying and deterring advisor misconduct.
As noted in Part II, regulators currently have informal authority to refer questions raised by firm or advisor conduct to other jurisdictions. And referrals can lead to subsequent enforcement actions: in 2019 alone, some 37 SEC enforcement actions arose from FINRA referrals. But there is no centralized, systematic mechanism for tracking what, if anything, a sister regulator has done in response to a referral. That is especially true as between federal authorities like FINRA and the SEC and state insurance regulators; although FINRA voluntarily identifies the referrals that produced SEC enforcement actions, there is little information regarding how state insurance regulators approach referrals.

Our evidence suggests that systematic tracking of the outcomes of referrals to state insurance regulators would be desirable. As we have shown, wandering advisors who depart the FINRA regime with a history of serious misconduct are far more likely than others to reoffend. Requiring FINRA to identify wandering advisors for state insurance regulators—and to track whether, and how, regulators respond to those referrals—will likely aid state regulators’ enforcement efforts. And tracking how state authorities respond to referrals can create desirable transparency related to states’ varying enforcement approaches.

See, e.g., supra text accompanying notes 47-49.

FINANCIAL INDUSTRY REGULATORY AUTHORITY, ACTIONS RESULTING FROM REFERRALS TO FEDERAL AND STATE AUTHORITIES, supra note 49.

As we have noted, some States take enforcement actions against as few as one out of every 1,000 insurance producers. SCHWARCZ & SIEGELMAN, supra note 82, at 44. What’s more, state insurance regulators—who are also charged with responsibility for insurers’ solvency—frequently worry that significant misconduct penalties will endanger the firm’s ability to pay policyholders. See, e.g., Cameron Huddleston, What Happens If Your Insurance Company Goes Out of Business, FORBES (May 11, 2020). For this and other reasons the penalties imposed by insurance regulators for advisor misconduct tend to be lower than those imposed by securities regulators, although some States have recently introduced legislation designed to increase insurance-regulator penalty authority.
Importantly, increased regulatory focus on referrals across regimes are exactly the type of regulatory activity wandering advisors may hope to avoid. Hence, improved coordination should also reduce incentives to wander for potential recidivists.

B. Licensing Regimes’ Institutional Design

The prevalence of wandering advisors also offers lessons for the design of financial advisory licensing regimes. In particular, our evidence suggests that lawmakers would do well to emphasize ongoing review of already-licensed advisors who have chosen to exit another financial advisory regime.

While FINRA, the SEC, state insurance regulators and the NFA conduct ongoing review of financial advisors, the most stringent licensing barriers are typically imposed at the point of initial registration. That choice is both typical of licensing regimes generally and intuitive, given that a frequently stated purpose of licensing regimes is to exclude

See, e.g., Thomas C. Lauerman, New Enforcement Powers for NYDFS? More Sanctions and More Defendants (April 13, 2020) (noting that the most recent budget proposal presented by the Governor of New York would increase regulators’ authority to impose penalties substantially). We take no view as to the optimal balance among these considerations when state insurance authorities impose penalties for advisor misconduct. Instead, we argue only that improved information flow between federal and state regulators would help the latter more efficiently target wandering advisors—who, the evidence shows, pose significant risk for investors.

See, e.g., Coryanne Hicks, How to Become a Financial Advisor, U.S. NEWS & WORLD REPORT (Jan. 30, 2020) (describing the significant entry requirements for becoming a FINRA broker or ’40 Act adviser, including FINRA-administered examinations).
unqualified individuals from a profession requiring expertise. Our evidence suggests that, with the exception of the insurance regime, initial screening deters entry of advisors with a past record of misconduct.

But the evidence in this Article also indicates that more stringent ongoing review of already-licensed financial advisors is warranted when those advisors choose to exit another regulatory regime. An advisor with a history of misconduct serving both as a FINRA broker and, for example, a state-regulated insurance producer is subject to considerably more oversight and disclosure of future misconduct. But if that advisor wanders by exiting the FINRA regime, we show, she is subject to less oversight—and, as an empirical matter, is more likely to reoffend.

Thus, lawmakers should consider requiring review of the licenses of financial advisors who exit other regulatory regimes. Such a review would help most efficiently identify advisors who pose the most significant risk of misconduct—and provide both regulators and advisors with an opportunity for additional training and education related to the advisor’s increased reliance on a particular regulatory context.

C. Insurance Regulation

Finally, a significant number of wandering financial advisors exit the FINRA regime in order to work as state-regulated insurance producers. While complete consideration of the insurance-regulation landscape is beyond the scope of this Article, we identify two prominent institutional characteristics in this area that warrant lawmakers’ attention.

\[119\] See, e.g., Aaron S. Edlin & Rebecca Haw Allensworth, Cartels By Another Name: Should Licensed Occupations Face Antitrust Scrutiny?, 162 U. PA. L. REV. 1093, 1102 (2014) (documenting the increasing breadth of state-level licensure requirements and their oft-stated, if debated, regulatory purpose).
Wandering Financial Advisors

1. Limited firm-imposed discipline. Insurance producers can, and often do, operate independently of a firm, so there is limited institutional sponsorship or oversight of individual producers. 120 By contrast, for example, a FINRA broker must be employed by a registered brokerage firm, and that firm is responsible for monitoring the conduct of its brokers. Should a firm fail to monitor, it will be disciplined. 121

In this way, FINRA’s oversight benefits from the work of brokerage firms, who serve as regulatory intermediaries. And an increasingly extensive body of empirical evidence shows that, while the labor market is an imperfect mechanism for disciplining broker behavior, firms nonetheless play an important role in deterring misconduct. 122

State insurance regulators, however, receive limited assistance from insurance firms as intermediaries to address producer misconduct. Because many of these individuals are self-employed, and even the misconduct of insurer-affiliated producers poses relatively limited risk to an insurance company, the firms lack meaningful incentives to thoroughly research, monitor, and discipline producers.

Policymakers concerned about the harm caused by wandering advisors should consider arrangements that would give insurance firms reason to deter producer misconduct. For example, insurance companies

120 See, e.g., Brown & Minor, supra note 76, at 10-11 (documenting this fact).
121 FINANCIAL INDUSTRY REGULATORY AUTHORITY, Rule 3010 (2018) (“Each [firm] shall establish and maintain a system to supervise the activities of each [broker] that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable [FINRA] Rules. Final responsibility for proper supervision shall rest with the [firm].”).
122 See, e.g., Egan et al., supra note 10, at 1 (“Firms discipline misconduct: approximately half of [FINRA brokers] lose their jobs after misconduct.”).
could be required to disclose information about their current and former producers in a straightforward manner. And producers who operate independently could be required to be insured\textsuperscript{123} for customer harm so that insurance markets provide a disciplinary mechanism.\textsuperscript{124} Such reforms would reduce the asymmetry between insurance and other regulatory regimes that encourages advisors with a history of misconduct to wander.

2. Investor remedies. Second, we note that individuals harmed by insurance-producer misconduct currently have limited remedies. Typically, such individuals can file a complaint with the state’s insurance authority and await a remedy. Although state insurance regulators now employ some 12,500 personnel, there is evidence that they also face considerable resource constraints.\textsuperscript{125} To the degree that these limited resources—and, hence, remedies—keep harmed individuals from

\textsuperscript{123} Although state law varies in the degree to which it requires insurance producers to carry insurance for harm imposed on customers, there is a robust market for professional liability policies for insurance producers. See, e.g., Patrick Chen, \textit{Business Insurance for Insurance Agents and Insurance Agencies}, ADVISORSMITH (Jan. 27, 2020) (providing examples of insurance-producer work that could expose the producer for liability for errors or omissions). Because insurance firms would, we think, be hesitant to insure producers with significant histories of misconduct, such a requirement might prompt the producers most likely to engage in misconduct to pay substantial insurance premia—or exit the market altogether.

\textsuperscript{124} Alternatively, Congress might mandate study of the costs and benefits of requiring that insurance producers be sponsored by firms. While we acknowledge that such a mandate would carry significant costs—and implications for the historically state-driven approach to insurance regulation—we think that emerging empirical work in the FINRA broker context offers encouraging evidence that the firm-sponsorship model of brokerage regulation has had desirable deterrence effects on broker misconduct. See generally Egan et al., \textit{supra} note 10.

\textsuperscript{125} See, e.g., \textit{National Association of Insurance Commissioners, State Insurance Regulation: History, Purpose and Structure} 2.
reporting producer misconduct, policymakers should consider two changes that would facilitate reporting and deterrence of such misconduct.

First, we note that many consumer misconduct complaints in this area emphasize compensation structures that firms provide to producers. Sales practices that federal regulators now acknowledge as problematic are still used to motivate a significant number of insurance producers. To the degree that insurance companies design and implement sales practices that encourage producers to engage in misconduct, lawmakers should consider whether consumer remedies should extend beyond the producer to the firm itself. Requiring insurance firms to pay judgments arising in these cases will provide firms with meaningful incentives to monitor the incentives they give producers more carefully.

Second, lawmakers should consider a dispute-resolution system for the insurance regime similar to that maintained by FINRA. Although that system is far from perfect, FINRA dispute resolution relies on trained arbitrators to resolve complaints quickly and cheaply. With rules that are sufficiently straightforward to allow complainants to pursue relief without expensive professional assistance, the system encourages consumers to report even misconduct that resulted in relatively small damages. To the

\[126\] See, e.g., SEC, supra note 9, at 263 & n. 594; see also id. at 265 (citing FINANCIAL INDUSTRY REGULATORY AUTHORITY, Rule 2320: Member Responsibility Regarding Deferred Variable Annuities (describing FINRA rules governing sales practices related to certain insurance products)).

\[127\] Current objections to FINRA’s system include the fact that some brokers fail to pay its judgments, see FINANCIAL INDUSTRY REGULATORY AUTHORITY, ARBITRATION AND MEDIATION: MEMBER FIRMS AND ASSOCIATED PERSONS WITH UNPAID CUSTOMER ARBITRATION AWARDS (2020) (documenting this issue and providing public disclosure of “firms and individuals responsible for unpaid customer arbitration awards”), and the extensive process permitting brokers to delete items from their disclosed misconduct history, see Honigsberg & Jacob, supra note 20.
degree that such reports allow regulators to identify advisors most likely to cause future harm, a system of this kind may help state insurance authorities struggling with the costs imposed by wandering advisors.

We acknowledge, of course, that these limited interventions may not be sufficient to address the significant costs imposed by financial advisor misconduct.\(^{128}\) But, in light of investors’ increasing reliance on financial advice, our findings suggest that lawmakers should move quickly to pursue straightforward reforms targeted toward the unique problems raised by wandering financial advisors.

**V. Conclusion**

Millions of American investors now rely on financial advisors to help them make crucial decisions that shape their financial futures.\(^{129}\) Advisor misconduct imposes substantial costs on these investors. But the law governing such misconduct is scattered across a fragmented set of federal, state, and self-regulatory institutions, giving advisors with a history of wrongdoing incentives to seek out regimes in which prior misconduct is least costly. In this Article, we have shown that such financial advisors—like police, teachers, and clergy who have previously

\(^{128}\) We acknowledge, for example, the important role strengthening the fiduciary obligations that insurance producers owe to customers in deterring and remedying misconduct. *But see supra* note 80 (citing *NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, CENTER FOR INSURANCE POLICY AND RESEARCH* (Nov. 11, 2020) (describing NAIC’s adoption of a more lax model standard)); *see also NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION* (2020). But we do not think broader policy changes of this type are mutually exclusive to those proposed in the text, which are more closely related to the evidence provided in this Article.

\(^{129}\) *See supra* note 5 (describing the effects of the shift from defined-benefit to defined-contribution retirement plans on American workers’ need for financial advice).
engaged in wrongdoing—“wander,” likely in search of a more lax jurisdiction in which to continue to provide financial advice.

Assembling a unique dataset of some 1.2 million advisors across four distinct institutional contexts, we have identified thousands of wandering advisors who continue to provide financial advice after exiting the brokerage industry. We show that advisors with a prior history of serious misconduct are significantly more likely than their peers to wander—and to commit misconduct in the future. And we identify state-registered insurance producers as the most common regime in which wandering advisors with a history of misconduct continue to work.

Our findings provide insights for the commentators and lawmakers now debating the future regulation of financial advice. We argue that the case for a single unified database of financial advisors is especially strong. We contend that strengthening mechanisms for regulator accountability could help address the costs imposed by wandering financial advisors. And our findings suggest that insurance firms could play a more meaningful role in monitoring advisor misconduct.

We hope that our evidence will focus lawmakers on the incentives that the fragmented law governing financial advice gives to those with a history of harming investors. Addressing those incentives should be a priority for policymakers concerned with the quality of the advice that millions of Americans now rely upon to plan their financial futures.