Do Commissions Cause Investment Adviser Misconduct?

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November 8, 2019

Abstract

Sales commissions may present a conflict of interest that allows investment advisers to obtain rents from uninformed clients. Alternatively, commissions might be a contracting solution to motivate information provision. To analyze the relation between commissions and adviser misconduct, I exploit quasi-exogenous changes in individual investment advisers' compensation arrangements caused by mergers between large registered investment advisory firms. The opportunity to earn sales commissions increases the probability that an adviser engages in misconduct, but competition is an important mediator. In regions with greater competition, sales commissions decrease misconduct claims. Increased misconduct from commissions is concentrated among low-experience advisers and male advisers. Damages paid out in claims involving commission-motivated advisers are $25,013 (36%) greater than other claims. The experimental design rules out latent firm and market explanations. Overall, I find that the connection between conflicts of interest and information provision depends on the competitive environment.

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1 Introduction

In markets with uninformed buyers and informed sellers, conflicts of interest may emerge. In the investment advisory industry, one potential conflict of interest stems from commissions. Commissions are payments from the sellers of financial products to financial advisers. When a naïve client approaches a financial adviser, the adviser may face a choice between recommending the best possible product and recommending a high-commission product. Will the adviser lie to make more money?

To address this question, I study the link between commissions and misconduct disclosures in the market for fiduciary financial advice offered by investment adviser representatives (IARs) in the United States. This setting provides several unique advantages. First, there is detailed, public data about individual investment advisers. These data include historical information on employment, licensing, and misconduct disclosures. Egan, Matvos, and Seru (2018a) find that approximately 7% of financial advisers carry a misconduct record. Second, registered investment advisory firms disclose their renumeration arrangements in annual filings with the Securities and Exchange Commission. Third, the regulatory environment permits advisers to earn commissions only if they hold certain licenses. By combining the licensing status of an adviser with the firm's renumeration policy, and I can determine whether an individual is eligible to earn commissions at any point in their career. Finally, the investment advisory industry and corresponding data is massive. In 2015, the industry held nearly $20 trillion in assets under management.[1] A recent survey by the Certified Financial Planner Board estimated that 40% of U.S. households use financial advisers.[2] The substantial availability of data allow for rich controls and analysis of theoretically-predicted mediators.

I begin by establishing whether a positive association exists between commissions and the likelihood of misconduct. Commission-motivated investment advisers are more likely to have disclosures related to misconduct. I proceed to test the causal effect commissions exert on adviser behavior. To identify causal effects, I exploit exogenous shocks to compensation contracts resulting from mergers of large financial advisory firms. I find that advisers who become eligible to earn commissions because of a merger are subsequently more likely to have misconduct allegations brought against them, especially allegations related to misrepresentation. However, in more competitive environments, commissions decrease the likelihood that advisers receive misconduct claims. The results are consistent with Bolton, Freixas, and Shapiro (2007) who propose that commissions might improve (worsen) information provision in more (less) competitive areas. I continue by examining how commissions affect the severity of misconduct. In cases ruled against advisers, damages awarded to clients involving commissions are higher.

That mis-selling might occur in markets with informed sellers and uninformed buyers is not new. Seminal

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[1] Figure 1 reports total assets under management (in billions) over the period 2001-2015.
[2] See:https://www.cfp.net/docs/default-source/news-events—research-facts-figures/2015-consumer-opinion-survey.pdf

work by Akerlof (1970) analyzes markets with quality differentiation. However, for financial products, *ex post* realizations of performance do not necessarily provide information on *ex ante* suitability, giving them qualities similar to credence goods or experience goods. Darby and Karni (1973) show that in credence goods markets, an equilibrium level of fraudulent behavior persists even under perfect competition. In contrast, pioneering work by Pauly (1979) discusses fee splitting, a form of kickbacks, in the medical field. He demonstrates that kickbacks might increase consumer welfare depending on the industry structure. In short, how incentives affect equilibrium levels of information provision is a classic economic question.

The more fitting theoretical settings for this work are those described by Bolton et al. (2007), Inderst and Ottaviani (2009), and Inderst and Ottaviani (2012). In all of these settings, commissions might improve or worsen information provision. In particular, Bolton et al. (2007) propose that monopolistic financial intermediaries have incentives to withhold information under sufficiently low reputation concerns. Applying this logic to the financial advisory market, monopolistic advisers have incentive to under inform or misinform clients to obtain additional rents. Later work by Inderst and Ottaviani (2012) show that commissions may emerge endogenously as a means of extracting rents from naïve consumers. In practice, investment advisers might lie about the properties of investments they recommend to steer clients towards high commission products. Under a conflict of interest hypothesis, commissions are used to extract rents from unsuspecting customers, increasing the frequency of misconduct claims.

However, when customers are wary, Inderst and Ottaviani (2012) show that commissions can be an incentive tool to induce the adviser to learn about complex products (or customers). Observationally, this suggests that consumers will receive better recommendations and more accurate information about their investments when commissions are available. Bolton et al. (2007) propose that competition can induce improved information provision by pressuring intermediaries to differentiate themselves. If the role of commissions is to enhance information gathering or provide product differentiation, then misconduct claims should decrease when advisers enter arrangements that include commissions. Under this hypothesis, commissions represent a contracting solution rather than a conflict of interest.

The potential conflicts of interest from commissions have not escaped notice from regulators. In 2012, the United Kingdom forbade financial advisers from receiving commissions from product providers. Similarly, the European Union recently prohibited independent financial advisers from receiving inducements – payments from financial product suppliers. In the United States, the Department of Labor considered enacting a fiduciary rule for broker-dealers, calling into question the compatibility of commissions and financial advice. Underlying these regulatory changes is the presumption that the conflict of interest from commission payments motivates rent-seeking behavior, such as fraud.

Empirical evidence is necessary to draw a conclusion on the link between commissions and financial

misconduct. To test the relation, I collect data on all investment adviser representatives registered on the Securities and Exchange Commission's Investment Adviser Public Disclosure database and all broker-dealer representatives registered on FINRA's BrokerCheck database. The data include histories of registrations, employment, exams, licensure, and disclosures. To allay concerns about the differences in standard of care, I only include IARs at RIA firms, i.e. individuals subject to the fiduciary rule. A key assumption of this paper is that IARs earn commissions when two conditions are met. First, they must be dual-registered as broker-dealer representatives. Second, they must work for a firm that allows the IARs to collect commissions. I obtain firm-level commission policy by merging the panel with Form ADV filings maintained by Dimmock and Gerken (2012). The resulting panel covers dataset covers 763,899 investment adviser representatives and 9,290 registered investment advisory firms.

In panel regressions, I find a strong positive relation between commissions and misconduct. One potential explanation for these results is that commissions motivate greater monitoring on the part of clients. To rule out this explanation, I classify misconduct disclosures using the text of allegations. I find that commissions are associated with increased rates of misrepresentation, i.e. financial advisers are more likely to lie about the investments they recommend to clients. This result is consistent with the hypothesis that commissions bias investment adviser recommendations by worsening information provision. I test whether allegations of other behaviors also increases. I find no connection between commissions and unsuitability claims, unauthorized trading behavior, nor negligence. The evidence is inconsistent with a general increase in client monitoring. Another potential explanation is a broad increase in lawsuits caused by commissions. I test whether dismissed, denied, and withdrawn claims increase with commissions, finding no relation. Finally, results are not explained by persistent individual characteristics. Fixed effects also rule out unobservable firm- or market-level variation. Nonetheless, the correlation evidence fails to account for endogenous labor-market matching and license acquisition. To address these concerns, I design a large-scale, multiple-event natural experiment.

To identify the causal effect of changes in compensation on an individual adviser's behavior, I restrict my attention to a set of plausibly exogenous changes in an individual's commission pay. I exploit two sources of variation. First, I use differences in IARs' dual registration as broker-dealer representatives. In order to register as a broker-dealer and earn commissions, individuals must pass a set of examinations. I use the history of examinations to classify individuals as dual-registered individuals. Second, I use changes in firm-level commission policy driven by mergers between large RIA firms. A key assumption for identification is that mergers are unanticipated by rank-and-file employees. Further, I assume that the M&A decision of larger RIA firms is not influenced by the preferences of individual investment adviser representatives.

I implement a multiple-event difference-in-differences-in-differences (DDD) framework. The treatment

group is composed of dual-registered IARs who experience a change in firm-level commission policy due to merger. Within a merger, the control group is the group of individuals who are not dual-registered, and therefore experience no change to their ability to earn commissions. The setting allows for placebo testing of dually-registered IARs who experience a merger but do not have a change in the compensation policy. The specification allows for robust merger-by-month controls, ruling out firm- and market-level latent variables as alternative explanations.

DDD estimates indicate a positive causal effect between commissions and misconduct. I estimate the causal effect of commissions increases misconduct rates by 33% representing an additional 2 cases of misconduct for every 10,000 adviser-months. Estimates focusing specifically on misrepresentation allegations are larger in magnitude. I find no evidence to suggest a causal connection between commissions and dismissed claims. The results suggest that, on average, commissions worsen information provision to clients.

To test whether competitive forces mediate the connection between commissions and misconduct, I split the sample into high and low competition areas based on geography. The market for retail investment advice is likely to be geographically segmented. A local adviser may have better knowledge of local laws, real estate investments, and living costs. Further, clients may prefer working with an adviser in face-to-face meetings, increasing costs for maintaining relationships with distant advisers. I use two parsimonious measures of competition. The first measure is simply the number of investment advisers in a particular zip code. Areas with an above-median number of advisers are considered more competitive. The second measure scales the number of advisers by the number and median income of local households. Areas with high household income per adviser are treated as lower competition areas.

Triple-difference estimates suggest substantial differences between high and low competition areas. In high competition areas, I find no evidence that commissions increase misconduct. I find that misrepresentations *decrease* under commissions when competition is fierce. For less competitive areas, commissions are associated with higher rates of misconduct and misrepresentation. Taken together, the results are consistent with the predictions of Bolton et al. (2007). Whether commissions are a conflict of interest or a contracting solution appears to depend on the competitive environment.

I move on to examine whether individual characteristics like industry and gender mediate the effect of commissions on misconduct. I find that advisers with less industry experience are more likely to engage in misconduct following the introduction of commissions. I also find that men are more likely to engage in misconduct than women, possibly due to differences in risk aversion or overconfidence as suggested by Barber and Odean (2001).

The results indicate that commissions increase the number of advisers who engage in misconduct on average. What are the changes along the severity of misconduct claims? To evaluate this question, I utilize

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a subsample of financial disclosures which include both the damages requested and paid in arbitration and court proceedings. Under a conditional linear model, I find that commissions are associated with a \$25,013 (36%) increase in damages paid, and a \$96,556 increase in damages requested. The results are robust to measures of firm size and account size.

The idea that financial advisers face conflicts of interest is not new. Dimmock and Gerken (2012) find the presence of conflicts of interest predict future fraud among investment management firms. In contrast, I study individual financial adviser incentives in a natural experiment and show that conflicts of interest may be contracting solutions in some cases. Mullainathan, Noeth, and Schoar (2012) finds that financial advisers fail to de-bias their clients, and instead push for actively-managed funds with higher expenses, but they do not study commissions directly. Closest to this paper is Anagol, Cole, and Sarkar (2017), who conduct field experiments in the Indian life insurance market and find that agents recommended strictly dominated products which provided higher commissions. My paper may be considered an *in vivo* follow-up to their experimental results, taking into account mediating forces like reputation and competition.

This paper joins existing literature in investigating financial adviser fraud. Dimmock, Gerken, and Graham (2018a) exploit mergers between financial advisory firms and find that fraud spreads via peer effects. Egan, Matvos, and Seru (2018b) study the relation between gender, adviser misconduct, and discrimination. They find that women are less likely to engage in misconduct, but are more likely to be fired for it. Dimmock, Gerken, and Van Alfen (2018b) examine how wealth affect an adviser's likelihood of misconduct by utilizing real estate shocks. Clifford and Gerken (2017) show that financial advisers are less likely to draw customer complaints when ownership of clients transfer from the firm to the individual adviser. However, in the same setting Gurun, Stoffman, and Yonker (2018) show that firms are also less likely to fire advisers for misconduct when ownership of clients passes to individuals. This paper differs from other work related to fraud by examining the explicit pecuniary incentives that motivate financial adviser fraud.

This article joins other work in studying the costs and benefits of financial advice for retail investors. Bluethgen, Gintschel, Hackethal, and Mueller (2008) find that financial advice enhances portfolio diversification. Gaudecker (2015) shows that financial advice benefits households with low financial literacy by improving diversification. Nonetheless, Foerster, Linnainmaa, Melzer, and Previtero (2017) find that financial advisers fail to customize portfolios for their clients; instead, the adviser's own asset allocation predicts the portfolio recommendations for their clients. Bhattacharya, Hackethal, Kaesler, Loos, and Meyer (2012) conduct a field study offering unbiased financial advice to a set of active retail customers. They find that most investors do not obtain or do not follow the advice. Further evidence suggest that households with financial advisers have greater turnover, lower Sharpe ratios, and more allocation to high-fee products (Hackethal, Inderst, and Meyer, 2010; Hackethal, Haliassos, and Jappelli, 2011).

Relative to existing work, this paper makes the following contributions. First, this paper uses a large-scale natural experiment to identify the link between financial adviser commissions and fraud in the United States. I find that commissions increase investment adviser misconduct on average. The results are not explained by firm- or market-level latent variables. The results are also not a result of differences in the standard of care across investment advisers and broker-dealers. Second, this paper empirically shows that competition mediates conflicts of interest. I find that commissions might improve information provision when competition is sufficiently high. The results suggest that policies banning commissions should consider the degree of competition in the advisory market. Third, I create a novel database that expands upon the efforts of Egan et al. (2018a), increasing the RIA sample to over 9,000 firms and validating the correlation evidence they find on the link between commissions and fraud. Finally, I find that *ex post* damages are greater when commissions are present. Altogether the results of this paper demonstrate that information provision under commissions depends on the competitive environment.

2 Data and Variables

2.1 Individual Financial Advisers and Misconduct

To study individual-level behavior, I obtain all profiles of individuals listed on the Financial Industry Regulatory Authority's (FINRA's) BrokerCheck database as of September 2017. The database includes names, unique Central Registration Depository (CRD) identifiers, employment histories, licensing information, exam dates, and disclosure records. The data covers both investment adviser representatives (IARs) and broker-dealer representatives (BDRs). Colloquially, both of these groups are called "financial advisers", but there are key differences in their duties, compensation, licensing, and standard of care.

IARs are personnel in registered investment advisory firms (RIAs) qualified to charge fees in exchange for providing financial advice. IARs will typically have passed their Series 65 exams, though some state regulators waive this requirement if the individual has obtained a CFP, CFA, or other professional designation. All IARs in my sample are registered with the United States Securities and Exchange Commission (SEC), but not all IARs are required to register at the federal level. Importantly, IARs are required to comply with the fiduciary standard, placing their client's interests above their own.[3]

Broker-dealer representatives, on the other hand, are primarily salespeople working within broker-dealer firms. Importantly, BDRs may earn product commissions from the sale of certain financial products. Broker-dealers may not charge clients for financial advice. Any recommendations provided by BDRs to their clients

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[3]See: https://www.sec.gov/divisions/investment/advoverview.htm

is considered incidental to their primary duty of selling products. The testing requirements for BDRs also differ from investment adviser representatives. Typically, the testing requirements for BDRs are related to the securities for which they facilitate transactions. For example, BDRs who have passed the Series 6 exam are authorized to sell only mutual funds, variable annuities, and similar products. Passing the Series 7 examination allows a BDR to sell a wider assortment of securities including individual equities. BDRs are also subject to a less stringent standard of care than IARs: the suitability standard. BDRs must have a "reasonable basis to believe" a product is suitable for the customer, but do not bear any fiduciary responsibility.[4]

Individuals may hold both types of registration simultaneously. Following Boyson (2019), I refer to individuals who are both IARs and BDRs as dually-registered investment advisers (DRs). A dually-registered investment adviser is permitted to charge fees for offering financial advice and to collect commissions from sales of financial products. I define variable $DualReg$ as an indicator equal to one if the individual is dually-registered. Because the standard of care differs between IARs and BDRs, I restrict my attention exclusively to individuals who are subject to the fiduciary standard (i.e. IARs and DRs). Focusing on this subsample mitigates concerns that differences in behavior are due to differences in the standard of care.

To create misconduct measures, I utilize the individual-level disclosures included in the BrokerCheck database. A disclosure appears on a person's record if a lawsuit or formal complaint is filed against him, or if he discloses information voluntarily in compliance with FINRA's disclosure rules.[5] FINRA sorts disclosures into the following categories: Civil, Criminal, Customer Dispute, Employment Separation After Allegations, Financial, Judgment/Lien, and Regulatory. Civil and Criminal cases enter their respective court systems. Customer Disputes are handled by FINRA's arbitration and mediation system. Employment Separations After Allegations are cases where individuals are permitted to resign from the firm or otherwise pushed out of employment following allegations of misconduct. Financial and Judgment/Lien cases involve bankruptcies, foreclosures, or other judgments against the adviser for failure to pay liabilities in a timely manner. Finally, regulatory cases are those brought by the SEC, FINRA, or state regulators.

The disclosure data includes filing dates, allegations, resolutions, damages paid/requested, settlement amounts, and other details. To classify a particular disclosure as being financial misconduct, I follow Egan, Matvos, and Seru (2018). I exclude disclosures categorized as Financial or Judgments/Liens. These disclosures are unlikely to represent fraudulent behavior with regard to the advisory business itself. Disclosures involving claims that are dismissed, denied, or closed without action are also excluded, as there is insufficient evidence in these cases that misconduct has occurred. Finally, pending investigations and those which are

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[4]See: https://www.finra.org/industry/suitability
[5]See: https://www.finra.org/industry/rule4530

on appeal are not counted towards misconduct. Settled claims are included, so are claims ruled against the financial adviser.

Each disclosure record is tied uniquely to one of the above categories; however a single act of misbehavior may generate several disclosure records at once. For example, a financial adviser who has been stealing client funds might face regulatory scrutiny, customer complaints, and criminal lawsuits around the same time period. To minimize concerns of double-counting, I collapse all misconduct disclosures into a indicator variable, *All Misconduct*, equal to one if a financial adviser is charged with any form of misconduct in a given month. Similarly, other misconduct measures are indicators equal to one if the financial adviser has a misconduct-related disclosure from a given category for that year.

For many of the observed claims in the database, there is a description of the allegations made against the financial adviser. Using keyword searches of the text included in the allegation, I categorize misconduct into specific behaviors similarly to Egan et al. (2018a). I create the variable *Misrepresentation* which is equal to one if allegations are related to the quality of information provided. The group includes misrepresentation, fraud, and omissions. Misrepresentations are false statements made by the adviser to the client. Misrepresentations include cases of fraud, which are intentional lies. Fraud has a higher legal bar to prove guilt, as plaintiffs must prove intent. I also include omissions as these cases reflect poor information provision. The second behavior I examine is recommendations of unsuitable investments. Included in this category are breaches of fiduciary duty. I define *Unsuitable* as an indicator equal to one if the allegation mentions suitability concerns. Third, I examine excessive/unauthorized trading behavior or churning. Financial advisers who obtain upfront commissions on the sale of products have incentives to churn their clients' portfolios. However, advisers might receive trail commissions–payments made for maintaining a position. I define *Negligence* for claims where the adviser is accused of negligent behavior and/or failure to execute trades or follow instructions. The categories so far are non-exhaustive and overlapping. The final category *Dismissed* is an indicator equal to one if the misconduct claim is dismissed, denied, withdrawn, or otherwise ruled against the client.

2.2 Firms and Compensation Policy

This paper seeks to understand the effects of commissions on the behavior of IARs. Investment adviser representatives are employees of registered investment advisory firms (RIAs). RIAs might be fee-only businesses, restricting their representatives from collecting commissions. A key assumption of this paper is that investment advisers earn commissions if two conditions are satisfied. First, investment advisers must be dual-registered as broker-dealers to earn commissions. Second, their employing RIA must allow them to

collect commission payments.

The United States Securities and Exchange Commission mandates that RIAs file disclosures of the firm's operations annually under Form ADV. Form ADV includes a host of disclosures related to business practices, ownership, assets under management, conflicts of interest, and past misconduct. Critically for this study, Form ADV requires RIA firms to disclose how they are paid. Form ADV specifies six different forms of remuneration: fees based on a percentage of assets under management, hourly fees, subscription fees (for a periodical), fixed fees, performance fees, and commissions. Importantly, I do not observe the intensity of these compensation arrangements; rather I observe an indicator equal to one if the firm claims to earn remuneration from that source in a given year. I define the indicator variable $RIACommissions$ if the RIA charges commissions in a given year.

Using Form ADV data collected and maintained by Dimmock and Gerken (2012), I begin with a sample of 24,490 RIAs from 2001-2015. I exclude year 2000 due to the sparseness of data for that year. I also eliminate all firms where compensation policy data is missing. Because I am interested in how financial advisers operate with retail clients, I further exclude any firms reporting no individuals as clients.

Utilizing perfect matches via Central Registration Depository (CRD) identifiers, I combine the BrokerCheck data with the RIA data. I construct a yearly panel of IARs working in RIAs from the period 2001-2015. For advisers who work in multiple firms in a given month, differing compensation structures across the firms may confound the analysis. Due to this concern, I retain observations where an individual is tied uniquely to a single firm. The resulting dataset contains 4,334,879 adviser-year observations covering 763,620 IARs and 9,290 registered investment advisory firms. Finally, I define $Commissions$, an indicator variable that equals one if the adviser is both dual-registered and working for a firm that charges commissions (i.e. $DualReg \times RIACommissions$).

I present summary statistics of individual-level data in Panel A of Table 1. Approximately 7% of adviser-year observations involve dual-registered advisers working in a firm that charges commissions. 21.4% of advisers-years involve dual-registration as a broker-dealer. The average adviser has roughly 8 years of industry experience based on their first appearance in the dataset. On average, advisers have 4 years of tenure at their firms. To identify gender, I follow the methodology of Egan et al. (2018b) using the Genderchecker database. Using this method, I estimate that 21% of advisers-years are female, and 61% are male. The remaining percentage are individuals who had unisex names or whose names did not appear in the Genderchecker database.

Panel B of Table 1 provides summary statistics on rates of misconduct by adviser-year. Estimates are scaled by 10,000. The average rate of misconduct disclosures is 79 cases per 10,000 adviser-years. Breaking this into subcategories, misrepresentation and unsuitability allegations occur at a rate of 24 and 29 cases

per 10,000 adviser-years, respectively. Allegations involving unauthorized trading and negligence are less common, occurring at rate of 12 and 8 cases per 10,000 adviser-years. Finally, there are roughly 49 cases per 10,000 adviser-years that are eventually dismissed, denied, or withdrawn.

I present summary statistics for firm-level variables in Table 2. Panel A of Table 2 presents compensation-related variables at the firm-year level. 14% of firm-years reported earning commission payments. Investigating fees, we see that the vast majority (97.32%) of firm-years involve collecting a percentage of assets under management. Roughly half of firm-years are reported earning hourly fees or fixed fees. RIAs charge performance fees in roughly 16% of firm-years.[6] Subscription fees, charged for RIA periodicals, are present only for 1.45% of firm-years.

Form ADV requires firms to report an approximate percentage of their clients who are non-high-net-worth individuals. A breakdown of the proportion of firms reporting is provided. Roughly 19% of firms report having no individual clients. The emphasis of this paper focuses on the interaction of investment advisers with uninformed, unsophisticated clients, so I exclude these firms from further analysis.

Panel B of Table 2 reports firm-level variables of interest. AUM is the firm's reported assets under management. The median RIA holds $163 million in assets under management, but the mean is $3.6 billion. The maximum assets under management is reported by Wellington Capital Management in 2010: $1.607 trillion. $N\ Accounts$ is the firm's reported number of accounts. The median firm reports 285 accounts, while the average is 3,087. The maximum number of accounts in the data is reported by Morgan Stanley Smith Barney, LLC in 2011 at 1,593,074. Finally, the typical average account size is $17.3 million, though the median average account size is $500,000. The maximum reported average account size is reported by UBS Warburg LLC. The company reported a single account of $11 billion.

3 Adviser Compensation and Misconduct

3.1 Are commissions and fraud positively related?

Utilizing the panel of investment adviser representatives, I examine whether there is a relationship between commissions and financial adviser fraud. The null hypothesis is that commissions have no association with misconduct. There are two alternative hypotheses. If commissions provide information-gathering incentives to financial advisers, misconduct disclosures will be negatively associated with commissions. On the other hand, if commissions instead provide incentives to bias advice and extract surplus from consumers, there will be a positive relation between commissions and misconduct claims. Individual characteristics, firm

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[6]RIAs may charge performance fees only to "Qualified Clients" who pass one of three tests: a) $1M of assets under management with the RIA; b) a $2 million net worth; or c) be an insider of the RIA. These limits were updated in 2012. See: https://www.sec.gov/news/press-release/2012-2012-29htm

variables, and market-wide effects may influence the rate of misconduct. To control for latent firm and market variables, I include firm-by-year fixed effects.

Egan, Matvos, and Seru (2018) show that gender is an important determinant for individual rates of misconduct. They find that women engage in misconduct less frequently than men do. This may be driven by differential risk-taking as studied by Barber and Odean (2001). To control for unobserved heterogeneity at the financial adviser level, I include individual fixed effects, thereby absorbing any persistent, person-specific characteristics. I test the hypothesis that the presence of commissions is positively or negatively associated with misconduct using panel regressions specified as

$$Misconduct_{i,j,t} = \beta_1 Commissions_{i,j,t} + \beta_2 DualReg_{i,t} + \nu_i + \gamma_{j,t} + \varepsilon_{i,j,t}. \tag{1}$$

$Misconduct_{i,j,t}$ is an indicator variable equal to one if a misconduct claim is filed against adviser i at firm j at time t. $Commissions_{i,j,t}$ is an indicator equal to one if the adviser is dual-registered and is working in a firm that charges commissions at time t. $DualReg_{i,t}$ is an indicator for individuals who are dual-registered. ν_i is an individual fixed effect. $\gamma_{j,t}$ is a firm-by-year fixed effect. The variable $RIACommissions$, representing firm-level commission policy, is absorbed by firm-by-year fixed effects. The primary coefficient of interest is β_1, representing the relationship of commissions with the misconduct outcome. If commissions are a conflict of interest (contracting solution), β_1 will be positive (negative).

Table 3 presents coefficient estimates of linear panel regressions of adviser-level misconduct on advisers' eligibility to earn commissions. Coefficient estimates are scaled by 10,000. The results in Table 3 indicate a positive relation between misconduct disclosures and commissions at a rate of 10 per 10,000 adviser-years. This represents a 13.5% increase over the baseline. Individuals who carry a dual registration but work for a fee-only RIAs have substantially lower rates of misconduct than adviser with only a IAR license. The results cannot be explained by persistent individual characteristics or latent time-varying firm variable. The estimates are consistent with commissions being associated with poorer information provision.

An alternative explanation for the results might be an increase in either clients' monitoring activity or their willing to sue. To address the former, I examine the allegations made against advisers. Under a client monitoring hypothesis, non-information related misconduct claims should also increase. I do not find evidence that commissions are related to higher rates of unsuitability, unauthorized trading, or negligence. To address the latter concern, I test if commissions are associated with an increase in dismissed cases. I find no evidence that the number of these cases increases. Examining the behaviors through which misconduct disclosures occur, the strongest increase stems from information-related misconduct.

Table 3 also presents a negative relation between $DualReg$ and misconduct. It is important to remember

that *Commissions* is the interaction of *DualReg* and *RIACommissions*. In this specification, *DualReg* identifies those individuals who hold a broker-dealer license but nonetheless continue to work for an RIA that disallows commissions. The negative relation to misconduct likely captures those who insist on remaining unbiased. The negative coefficient persists when examining allegations as well. The economic magnitude of the decrease is substantial. Individuals with dual registrations working at commission-restricting firms have nearly half the number of misconduct disclosures as the baseline.

Using the full sample of individuals for which I have employment data, disclosure data, and compensation data, I find a positive relation between commissions and misconduct claims, especially claims related to misinformation. The results are robust to inclusion of firm-by-year fixed effects, controlling for latent firm variables such as culture or policies. The analysis includes individual fixed effects to absorb the persistent characteristics of the financial adviser. The results are consistent with the hypothesis that commissions represent a conflict of interest. However, the analysis thus far lacks identification, as endogenous labor-market matching may be confounding the results. A positive relation exists, but to establish a causal effect, I turn to quasi-exogenous changes to compensation arrangements.

4 The Causal Effect of Commissions on Fraud

4.1 Background on RIA Mergers

Proper identification of the causal effects of commissions on misconduct requires exogenous changes to individuals' compensation arrangement. Because individuals endogenously match with their preferred forms of compensation through the labor market, the results of panel regressions could be driven by selection of misconduct-prone, dually-registered financial advisers to commission-paying firms. To capture the causal influence of commissions on misconduct, I utilize changes to an individual's compensation arrangements driven by mergers and acquisitions between large RIAs.

Figure 3 outlines the experimental design. Consider a dually-registered investment adviser working in a target firm that disallows commissions (i.e. *RIACommissions* = 0). When an acquirer with a differing policy obtains the target, the investment adviser can earn commissions. The adviser experiences a change in his compensation policy that is not a result of labor market matching. The key to identification in this setting is that M&A activity among RIA firms is exogenous and unanticipated to the individual financial adviser. Rank-and-file employees at RIA firms are unlikely to be important decision-makers in the M&A decision.

I rely on the set of mergers and acquisitions identified by Dimmock, Gerken, and Graham (2018) using

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mass transfers of individual adviser registrations from one firm to another. The authors further verify their set of mergers using news articles and mergers published in Hong and Kacperczyk (2010). I then restrict the sample of mergers to those occurring between registered investment advisory firms, i.e. mergers where I observe compensation arrangements before and after the merger. This restriction leaves 141 mergers for the sample. Likewise, I restrict the period following the merger to ensure that commission-policy at the acquirer remain constant. I select a maximum event window of 72 months surrounding the merger event. The resulting sample is an unbalanced panel containing 3,942,906 adviser-month observations. The sample covers 61,223 financial advisers and a total of 141 mergers.

4.2 Difference-in-differences-in-differences Specification

To test the causal effect of changes in compensation on misconduct, I implement a multiple-event difference-in-differences-in-differences (DDD) specification. The first difference is between IARs with and without broker-dealer licenses. The second difference is between RIA firms that do or do not charge commissions. Together, these two interactions are represented by the *Commissions* variable. The final difference is pre-merger versus post-merger. By employing a DDD setting, I examine differences between individuals within the same merger, ruling out latent firm-level variables such as culture or firm policies unrelated to commissions.

In this setting, mergers may either newly allow, disallow, or keep constant and individual's earnings from commissions. In total, the specification requires three different group variables. Treated groups are those individuals who experience an introduction or removal of commissions due to differences between target and acquirer policies. Control groups are composed of those individuals who do not experience a change in commissions.

To draw inference from DID estimation, treatment and control groups must satisfy the parallel trends assumption. In Figure 4, I present average residuals of misconduct rates for both sets of treated and control groups for 36 months before and after mergers. The figures show a lack of any obvious trends in misconduct rates in the pre-event period.

To estimate the effects of changes on compensation structure on various forms of misconduct, I run the following specification:

$$
\begin{aligned}
Misconduct_{i,j,t} =& \beta_1 Commissions \times Post_{i,j,t} + \beta_2 DualReg \times Post_{i,t} \\
& + \beta_3 Commissions_{i,j,t} + \beta_4 DualReg_i + \gamma_{j,t} + \varepsilon_{i,j,t}.
\end{aligned}
\tag{2}
$$

$Misconduct_{i,j,t}$ is an indicator variable equal to one if individual i has a misconduct claim brought against

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them in month t. $Commissions_{i,j,t}$ is an indicator equal to one if a dual-registered investment adviser works under a firm that earns commissions during that month. $DualReg_i$ is an indicator equal to one if the investment adviser is registered as a broker-dealer. $Post$ equals one after the merger completes. $\gamma_{j,t}$ is a merger-by-year fixed effect that absorbs the commission policies of both the target and acquirer, $Post$, and market effects. The coefficient of interest is β_1 which captures the causal relation between commissions and misconduct.

Table 4 reports estimates from the DDD regressions. Coefficients are scaled to a rate of 1 disclosure per 10,000 adviser-months. The coefficient of $Commissions \times Post$ measures the causal effect from the introduction of a commissions on the conditional probability of a misconduct disclosure. The coefficient estimate for all cases of misconduct implies a causal increase of 2 cases per 10,000 adviser months, a 33% increase over the baseline probability. Coefficient estimates on $DualReg$ and $DualReg \times Post$ both load negatively. Relative to single license peers, dually-registered agents have lower rates of misconduct.

Examining allegations related to misinformation, commissions appear to decrease the quality of information provision. Commissions are associated with a 38% increase in information-related misconduct, and additional 2.5 cases per adviser-month. These results cannot be explained by latent firm or market variables due to the inclusion of merger-by-month fixed effects. To rule out the possibility that clients are simply suing advisers more frequently, I again test dismissed cases and find that the number of cases ruled against clients does not increase with commissions.

Table 5 presents tests of the symmetric effect of commissions on misconduct. Point estimates are roughly similar to those from the full model. Effects are primarily attributable to increased misconduct among individuals who are newly introduced to commission rather than from individuals who are newly barred from them. Altogether, the results of the DDD estimation suggest a causal link between commissions and fraudulent behavior. These results are consistent with the hypothesis that commissions act as a conflict of interest that biases advice and weakens the information provision incentive. The estimates are inconsistent with an information-gathering or differentiation motive. The desire for advisers to differentiate themselves, however, depends on a competitive environment. I next examine how competition mediates the role of commissions.

4.3   The Mediating Role of Competition

Bolton et al. (2007) study the role of competition on commission-related misconduct, showing that competition can foster information provision and decrease conflicts of interest by encouraging advisers to differentiate themselves from other advisers. On the other hand, Klein and Leffler (1981) show that the potential for

future quasi-rents might assure contractual performance and induce investment into a good reputation. However, the presence of quasi-rents relies on pricing power, so advisers in more competitive areas might not find their reputations to be valuable. Finally, Darby and Karni (1973) suggest that misconduct will occur even in perfectly competitive markets for credence goods. Does competition dull, exacerbate, or do nothing for the relationship between commissions and misconduct?

To study this question, I measure competitive pressures using geographical market segments. I argue that the investment advisory business is likely to have geographic segmentation. Advisers who are co-located with their clients are likely to have better understanding of local laws and markets. Clients may also prefer to meet in-person with their advisers, especially to discuss sensitive topics. By choosing nearby advisers, clients can avoid costly travel costs. Apart from segmentation, I further assume the market for investment advice is close to monopolistic competition. The experience clients have with an adviser is likely unique, and advisers may be able to differentiate themselves.

Under these assumptions, I first measure the number of investment advisers at the zipcode level. This measure assumes that the more advisers are present in an relatively small geographic area, the tighter competition will be for local clients. I separate the sample into two groups based on the median number of advisers in the zipcode. High competition corresponds to above-median numbers of advisers. The second measure considers the wealth and number of clients as reported by the most recent contemporary U.S. Census and American Community Survey. I take the estimated number of households in the zipcode and multiply by the zipcode's mean household income. I then divide by the number of advisers in the zipcode. I again split the sample based on whether household wealth per adviser is above or below the median. The second measure adjusts for the amount of wealth in a particular market segment. Because the data cover large advisory firms, the use of geographically segmented data does not preclude the use of merger-by-month FEs.

I repeat the DDD analysis using these subsamples, presenting results in Table 6a and 6b. In Table 6a, I record coefficient estimates with all misconduct types as the outcome variable. Under either measure of competition, the high-competition subsamples have a negative coefficient for $Commissions \times Post$. The estimates fail to reject the null hypothesis that commissions do not affect rates of misconduct. In the low-competition subsamples, however, both coefficient estimates are greater than 5.7 cases per 10,000 adviser months. These estimates reject the null hypothesis in favor of the alternative. The previously discussed increase in misconduct due to commissions appears only when local competition is low.

In Table 6b, I focus on outcomes related to information provision. Again, for the high competition subsamples, coefficient estimates are negative, suggesting the commissions *decrease* misconduct. Under either measure of competition, the estimates reject the null hypothesis that commissions are unrelated to misconduct. Looking to the low-competition subsample, the coefficient estimates are positive and statistically

significant. For the low competition subsample, commissions worsen information provision as measured by misrepresentation allegations.

The results are consistent with the prediction of Bolton et al. (2007). Increased competition mediates the conflict of interest generated by commission payments. When focusing specifically on information provision, high competition combined with commissions may alleviate information asymmetry. The evidence is consistent with a story that advisers differentiate themselves from competitors by providing better information.

4.4   Experience and Gender

Advisers can separate themselves from the pack by building a reputation over a long career. I next examine whether more experienced advisers engage in commission-motivated misconduct more frequently. I measure an adviser's experience in the industry by calculating the number of years the adviser has been registered at any investment advisory firm or broker-dealer firm. I then separate the sample into $LowExp$ and $HighExp$, where the former represents individuals with below-median experience and the latter are persons with above-median experience.

I present coefficient estimates of the DDD specification using subsamples split on experience. The first pair of columns use all misconduct claims as the outcome. The second pair tests only for outcomes related to misinformation. The coefficient estimates on the treatment effect of commissions is positive across all models. The coefficients are greater for less experienced advisers and reject the null hypotheses. For seasoned advisers, the coefficient fails to reject the null hypothesis. The results suggest that more experienced advisers are less tempted to lie in order to obtain additional commissions.

Recent work by Egan et al. (2018b) find that female financial advisers are less likely to have misconduct disclosures and more likely to be fired when they have misconduct claims won against them. Barber and Odean (2001) suggest that males have lower risk aversion and are more likely to be overconfident. Misconduct is inherently risky. Taking the steeper punishments for females and the lower risk aversion of males as give, I hypothesize that male advisers will react to commissions by lying more frequently relative to their female peers. Following Egan et al. (2018b), I classify advisers as male or female by matching their first names with the Genderchecker database. Individuals who are unmatched or match with unisex names are excluded from the next analysis.

I present results in Table 8. When testing all types of misconduct, the coefficient estimate for males is greater than the estimate for females. However, both subsamples fail to reject the null hypothesis. Male advisers respond to commissions by increasing misrepresentations. The results of this test are consistent with the notion that male advisers are more likely than female advisers to lie for commissions. However, tests of

coefficient differences fail to reject the null hypothesis that male and female advisers behave similarly.

4.5 Commissions and Misconduct Severity

The evidence so far suggests that commissions increase the rate of information-related misconduct. However, commissions might decrease the overall damages from misconduct, substituting large infrequent frauds for small, frequent ones. Before reaching conclusion on whether the rent-seeking motive dominates the information-seeking motive, I investigate whether commissions are associated with greater rent-seeking on the intensive margin. I utilize the richness of the BrokerCheck data once again. For a subsample of misconduct claims, the data include fields on the damages paid and/or requested in completed customer disputes.

To estimate how commissions relate to the ex post damages using an ordinary least squares approach:

$$Damages_{i,j,t} = \alpha + \beta_1 Commissions_{i,j,t} + \beta_2 AUM_{j,t} + \beta_3 AvgAcctSize_{j,t} + \varepsilon_{i,j,t} \tag{3}$$

where $Damages$ represents either the damages paid or requested in a particular disclosure. $Commissions$ is an indicator equal to one if the adviser was working in a commission-earning firm when the disclosure was filed. AUM and $AvgAcctSize$ are the firm's reported assets under management and average account size, in thousands, in the year of the disclosure. $Fees$ are indicators equal to one if the firm reported a particular fee type in the year of the disclosure.

Table 9 presents results of the OLS estimation. Coefficient estimates are in US dollars. Results on indicator variables represent differences in group means. Commissions are associated with \$24,243-\$25,013 more in average damages paid and \$94,271-\$96,556 more in damages requested in misconduct claims. A \$1,000 increase in assets under management is associated with a roughly \$0.20 (2 basis points) increase in damages paid and requested. Having a \$1,000 increase in average account size is associated with a reduction in damages paid by \$14 and damages requested by \$31.

The evidence suggests that commissions cause not only with a higher extent of misconduct, but are correlated with greater intensity as well. Taken altogether, the results suggests that commissions are not tools by which savvy investors motivate information-gathering from financial advisers. Rather, commissions appear to be the means by which financial advisers extract rents from naïve investors.

5 Discussion

5.1 Policy Implications

Would a ban on commissions decrease the rates of misconduct? Such a ban might prevent monetary kickbacks to financial advisers. However, product suppliers might pay advisers using creative or illicit techniques. Further, commission bans in competitive markets might increase misconduct. To test the efficacy of commissions bans on rates of misconduct, I study the effects of a ban on commissions in the United Kingdom. In late 2012, the UK amended COBS 6.1A.4 R RP (COBS) as part of the Retail Distribution Review, a major overhaul of financial regulations. As part of these amendments, investment advisers with customer functions (CF30) were forbidden from taking payments from financial product sellers. I design and implement a difference-in-difference design around COBS where CF30s are the treatment group and other financial professionals are the control group. Table 10 presents the results of the difference-in-difference around COBS. The coefficient estimate of the treatment effect appears to decrease the rate of misconduct disclosures by almost 1 case per 10,000 adviser-years. The results are consistent with the notion that bans might reduce misconduct on average. Though, as this paper shows, a commission ban might result in poorer information provision in highly competitive areas.

Is reducing misconduct good for consumers? While the evidence presented in this paper shows a link between commissions and misconduct, this paper does not directly measure consumer surplus. As shown by Berk and van Binsbergen (2019), higher rates of misconduct are not necessarily associated with a decrease in consumer surplus. Indeed, the authors show that tighter regulations might decrease consumer surplus despite fewer cases of fraud. Simply, prices adjust to the new lower equilibrium level of fraud. Empirically, and related to COBS, the UK's Financial Conduct Authority's 2015 market review found that the commission ban led to a gap in advice "for people on lower incomes...who cannot afford to pay the fee for advice.[7]" Perhaps a partial pooling equilibrium with commissions for low-income clients and fees for high-income clients is optimal.

Finally, even if a ban on commissions were costlessly enforceable and assured to increase consumer surplus, there might not be efficiency gains. The gains in consumer surplus might carry a corresponding loss in producer surplus. Further research is needed on how producer surplus would change in response to a ban on commissions. To summarize, further evidence is needed to recommend a government policy towards commissions. Future research might attempt to evaluate the costs of enforcing commission bans, changes in the equilibrium price and quantity of advice, or the effects of commission bans on producer surplus.

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[7]https://www.fca.org.uk/publication/corporate/famr-final-report.pdf

6 Conclusion

In this paper, I investigate the link between commissions and misconduct in the financial advisory industry. Whether commissions induce higher or lower rates of fraud in the market for financial advice is not theoretically obvious. On one hand, commissions might provide incentives for financial advisers to engage in costly information-gathering, improving the accuracy of their recommendations. Commissions might also motivate advisers to differentiate themselves from others. On the other hand, commissions may be a means of extracting rents from unsophisticated clients. Using detailed data on individual financial advisers and firm-level data on compensation arrangements, I find that commissions are positively associated with claims of misconduct especially related to misinformation. Using exogenous changes to an individual's compensation structure driven by M&A activity, I find evidence of a causal link between commissions and misconduct. I examine specific misconduct behaviors using text of allegations and find that commission-motivated advisers are more likely to misrepresent material information when making recommendations to clients, but are not more likely to engage in churning or negligence.

I find empirical evidence that suggests competition may mediate or reverse the conflicts of interest introduced by commissions. In competitive areas, commission-motivated advisers are less likely to have misconduct claims brought against them, especially claims related to information. I find that experienced advisers and female advisers are also less likely to engage in misconduct when introduced to commissions. Finally, conditional on the discovery of misconduct, average damages paid in cases involving commissions-motivated advisers is $24,243 more than damages paid in other cases, even after controlling for assets under management and average account size.

Taken together, the results of this paper indicate that commissions can be both a means for extracting rent from naïve consumers and a tool for optimizing information provision. The contracting environment mediates the role of commissions. The overall results are consistent with the actions of regulatory authorities in the UK and EU who have banned commissions for certain financial advisers. However, the evidence in this paper suggests that policymakers should condition on the competitiveness of the industry, and the welfare effects of said bans require further research. This paper shows that apparent conflicts of interest can improve outcomes when competition is fierce.

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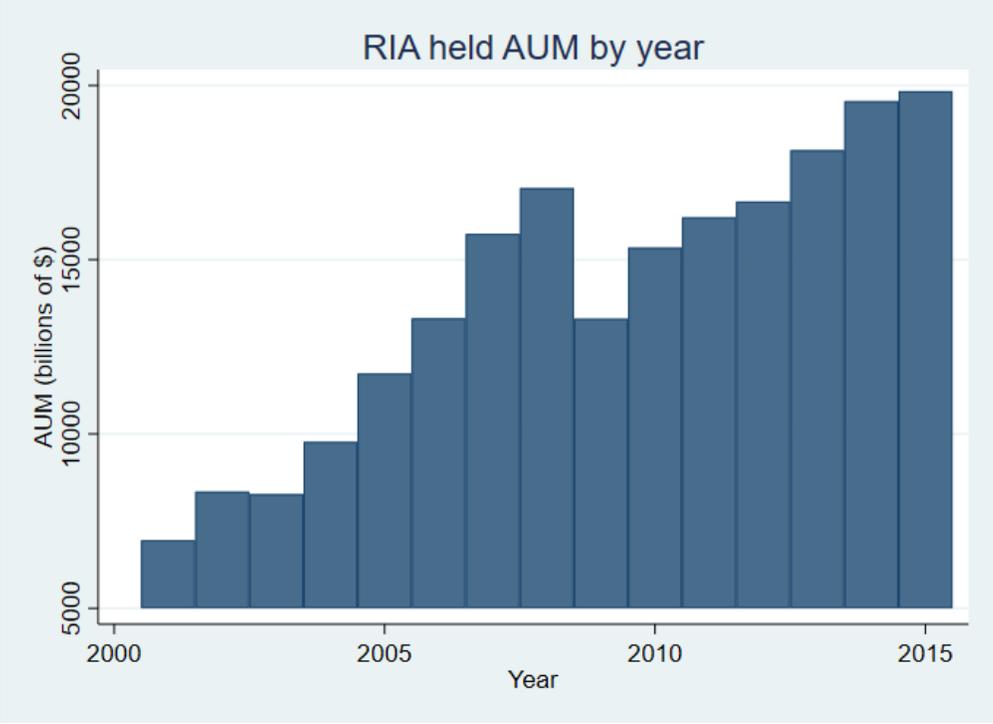
Figure 1: RIA Assets Under Management

This figure shows total dollar assets under management in billions of dollars from 2001 to 2015.
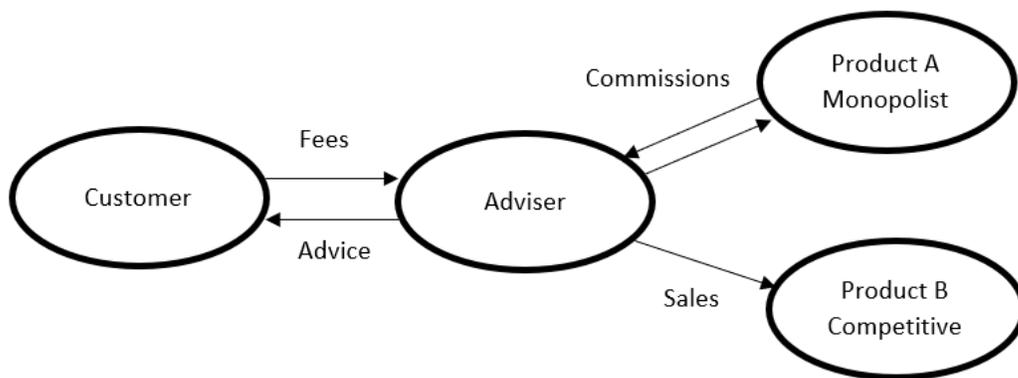
Figure 2: Commissions vs. Fees

This figure illustrates the difference between broker-dealer commissions and investment-adviser fees. Commissions are sales incentives paid from product suppliers to the adviser. Fees are payments made directly from the customer to adviser in exchange for financial advice. The possibility of commissions may introduce of conflict of interest that biases the adviser's advice. Alternatively, commissions may provide incentives to the adviser to gather more information about the seller's product.
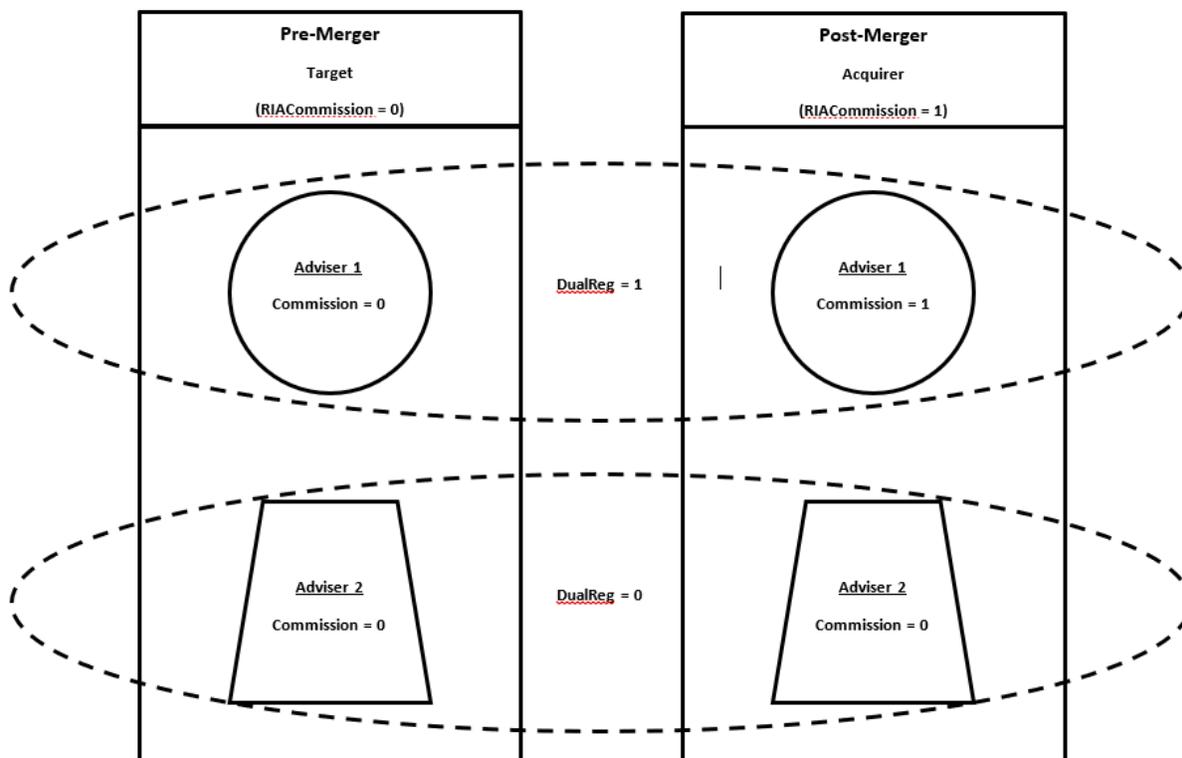
Figure 3: Experimental Design

This figure provides an example of the experimental design used to identify the causal effect of commissions from M&A activity. Prior to the merger, two advisers work at the target firm. Adviser 1 is a dually-registered adviser, eligible to earn commissions. However, the Target firm's disallows its advisers from earning commissions, so Commission = 0 for both advisers. Adviser 2 lacks a broker-dealer license, and is not dual-registered. Upon completion of the merger, Adviser 1 is permitted by the Acquiror to earn commissions. Adviser 2 still lacks the necessary licensure, acting as a control. By varying the commission policies of Target and Acquiror, differing treatment and placebo groups emerge.
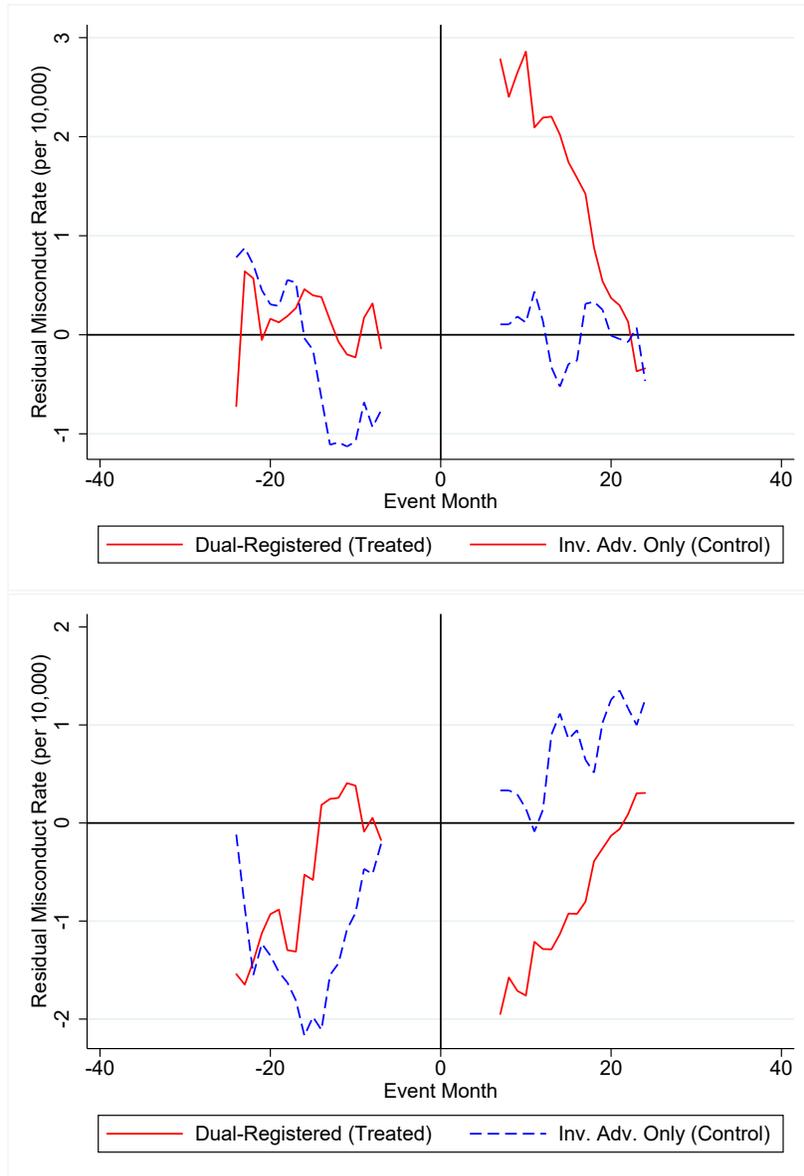
Figure 4: Parallel Trends Assumptions

These figures plot six-month moving-average misconduct residuals rates for registered investment advisers in the DDD sample. The top figure represents mergers in which the target does not charge commissions and the acquiror does. The bottom figure represents mergers in which the target charges commissions but the acquiror does not. Dual-registered advisers are eligible to earn commissions, and are affected by firm-level commission policy.

Table 1: Individual Summary Statistics

This table presents summary statistics on the individual investment adviser representatives. The sample consists of individuals registered on FINRA's Brokercheck database and the SEC's Investment Adviser database who worked for at least twelve months between 2001-2015. Observations are at the adviser-year level. *Commissions* is an indicator equal to one if the adviser was dual-registered and working in a firm that charged commissions. *DualReg* is an indicator equal to one if the adviser was dual-registered. *Experience* is the number of years the adviser has been in the industry. *Tenure* is the number of years the adviser has been at the firm. *Female* (*Male*) is an indicator equal to one if the first name is a female (male) name. All misconduct measures are indicator variables scaled to a ratio of 1 per 10,000. *Misconduct* is equal to one if the adviser has any allegations initiated in that month that are eventually settled or ruled against the adviser. *Civil* is an indicator equal to one if the adviser was sued in civil court that month and eventually lost or settled. *Criminal* equals one if criminal charges were brought against the adviser in that month. *Customer Dispute* indicates the adviser faced allegations through FINRA's customer arbitration system or firm-level channels in that month. *Regulatory* equals one if regulatory agencies brought an investigation that led to disciplinary action.

Panel A: Adviser-Month Summary Statistics

Variable	Mean	SD	N
Commission (%)	7.17	25.8	4,334,879
DualReg (%)	20.7	40.5	4,334,879
Female (%)	21.3	40.9	4,334,879
Male (%)	60.6	48.9	4,334,879
Unisex (%)	18.1	38.5	4,334,879
Experience	7.97	7.0	4,334,879
Tenure	3.95	5.2	4,334,879

Panel B: Rates of Misconduct (per 10,000 Adviser-Years)

Misconduct Measure	% of Advisers	SD (%)	N
Overall Misconduct	78.6	883.1	4,334,879
Misrepresentation	24.3	492.1	4,334,879
Unsuitability	28.9	536.4	4,334,879
Unauthorized Trading	12.2	349.5	4,334,879
Negligence	7.9	281.5	4,334,879
Dismissed	49.2	669.6	4,334,879

Table 2: RIA Summary Statistics

This table summarizes variables for registered investment advisory firms (RIAs) from 2001-2015, covering 57,156 firm-year observations. Panel A reports compensation arrangements. $RIACommission$ is an indicator equal to one if the firm reports earning remuneration via commissions in that year. $\%AUM$ represents firms that charge a percentage of assets under managment. $Hourly$ equals one when firms charge hourly fees. $Subscription$ represents fees charged for periodicals such as newsletters. $Fixed$ equals one when firms charge fixed fees other than subscription fees. $Performance$ represents firms that charge performance fees for any clients. Panel B reports account size information and a breakdown of the firm's self-report individual clientele base. AUM represents the firm's assets under management, in millions. $N\ Accounts$ is the firm's reported number of accounts. $AvgAcctSize$ is the firm's self-reported average account size.

Panel A: Compensation Summary Statistics (% of Firm-Years)

Compensation Type	Mean	SD	N
$RIACommission$	14.09%	34.80%	57,156
Fees			
$\%AUM$	97.32%	16.15%	57,156
$Hourly$	47.10%	50.00%	57,156
$Subscription$	1.45%	11.96%	57,156
$Fixed$	55.82%	49.66%	57,156
$Performance$	16.57%	37.18%	57,156
% of Clients who are Individuals			
$None$	18.86%	39.12%	57,156
$Up\ to\ 25\%$	40.22%	49.04%	57,156
$25\%\ to\ 50\%$	16.86%	37.44%	57,156
$50\%\ to\ 75\%$	13.27%	33.93%	57,156
$More\ than\ 75\%$	10.79%	16.15%	57,156

Panel B: Firm Summary Statistics (by Firm-Year)

Variable	Mean	SD	N	Min	p25	Median	p75	Max
AUM (millions)	3,601.72	27,1115.94	58,567	12.50	58.87	162.76	586.50	1,607,588
$N\ Accounts$	3087.44	34,970.18	58,192	1	86	285	794	1,593,074
$AvgAcctSize$ (millions)	17.28	169.54	58,192	0	0.21	0.50	1.76	11,000

Table 3: The Relation of Commissions and Investment Adviser Misconduct

This table presents evidence on the relation between the compensation arrangements of RIA firms and the individual-level propensity of misconduct using a linear probability model. All variables are indicators. Dependent variables are measures of misconduct that are equal to one if a financial adviser received one or more misconduct disclosures of that type in a month. Independent variables measures compensation arrangements at the firm-level. Coefficient estimates are scaled by 10,000. The unit of observation is an adviser-year. All of the regressions include individual and firm-by-year fixed effects. The standard errors are clustered at the firm level. Parentheses display t-statistics. Significance levels are indicated as follows: $^* = 10\%$, $^{**} = 5\%$, $^{***} = 1\%$

| | Misconduct Allegation | | |
| | *All Misconduct* | *Misrepresentation* | *Unsuitability* |
Compensation Type	(1)	(2)	(3)
Commissions	9.980***	8.964***	0.84
	(2.91)	(6.86)	(0.61)
DualReg	-32.989***	-5.916***	-5.544***
	(-13.19)	(-4.62)	(-3.81)
Individual FEs?	Yes	Yes	Yes
Firm × Year FEs?	Yes	Yes	Yes
N Observations	3,684,830	3,684,830	3,684,830
Adj. R^2	0.054	0.063	0.027

| | Misconduct Allegation | | |
| | *Unauthorized Trading* | *Negligence* | *Dismissed* |
Compensation Type	(4)	(5)	(6)
Commissions	0.240	2.628	0.516
	(0.36)	(1.51)	(0.06)
DualReg	-6.108***	-4.242***	-28.544***
	(-7.20)	(-7.16)	(-6.84)
Individual FEs?	Yes	Yes	Yes
Firm × Year FEs?	Yes	Yes	Yes
N Observations	3,684,830	3,684,830	3,684,830
Adj. R^2	0.014	0.009	0.008

Table 4: Merger-Identified Effect of Commissions on Misconduct

This table presents estimates from the triple difference regressions around changes to commissions caused by merger activity between RIA firms. The sample includes only investment advisers at target firms. All variables are indicators. The dependent variable is equal to one if the financial adviser had a misconduct claim initiated against him/her in that month. *Commissions* is an indicator equal to one if a dual-registered investment adviser works under a firm that earns commissions during that month. *DualReg* is an indicator equal to one if the adviser is dual-registered during the sample period. *Post* is equal to one for the period following the merger. Coefficient estimates are scaled by 10,000. The unit of observation is an adviser-month. All of the regressions include individual and merger-by-month fixed effects. Standard errors are clustered at the merger level. Parentheses display t-statistics. Significance levels are indicated as follows: $^* = 10\%$, $^{**} = 5\%$, $^{***} = 1\%$

	All Misconduct	*Misrepresentation*	*Dismissed*
Compensation Type	(1)	(2)	(3)
Commissions $\times$ *Post*	2.366*	2.513**	1.400
	(1.93)	(2.41)	(1.25)
DualReg $\times$ *Post*	-1.912*	-2.162**	-0.482
	(-1.89)	(-2.51)	(-0.52)
Commissions	-0.397	-0.638	1.113
	(-0.45)	(-0.85)	(1.38)
DualReg	-1.911***	-1.649***	-0.493
	(-2.70)	(-2.74)	(-1.44)
Merger $\times$ Month FEs?	Yes	Yes	Yes
N	3,942,580	3,942,906	3,942,580
Adj. R^2	0.001	0.002	0.000

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Table 5: Symmetry of Causal Influence of Commissions

This table presents estimates from the triple difference regressions around changes to commissions caused by merger activity between RIA firms. The first model excludes mergers where target firm charge commissions and acquirers do not. The second model excludes mergers where target firms do not charge commissions and acquirers do. All variables are indicators. The dependent variable is equal to one if the financial adviser had a misconduct claim initiated against him/her in that month. *Commissions* is an indicator equal to one if a dual-registered investment adviser works under a firm that earns commissions during that month. *DualReg* is an indicator equal to one if the adviser is dual-registered during the sample period. *Post* is equal to one for the period following the merger. Coefficient estimates are scaled by 10,000. The unit of observation is an adviser-month. All of the regressions include individual and merger-by-month fixed effects. Standard errors are clustered at the merger level. Parentheses display t-statistics. Significance levels are indicated as follows: $^* = 10\%$, $^{**} = 5\%$, $^{***} = 1\%$

	To Commission-Seeking	Away from Commission-Seeking
Compensation Type	(1)	(2)
$Commissions \times Post$	2.051*	1.524
	(1.74)	(1.15)
$DualReg \times Post$	-1.457	-1.308*
	(-1.17)	(-1.18)
$Commissions$	-0.436	0.359
	(0.45)	(0.36)
$DualReg$	-2.08***	-2.395***
	(-2.71)	(-2.86)
Merger $\times$ Month FEs?	Yes	Yes
Clustering	Merger	Merger
N	3,353,333	3,526,052
R^2	0.001	0.001

Table 6a: Competition and Commission-Related Misconduct

This table presents estimates from the triple difference regressions separated using measures of local competition. The dependent variable is equal to one if the financial adviser had a misconduct claim initiated against him/her in that month. In first pair of models, $HighComp$ is equal to one if the number of advisers in a zipcode is above the median. In the second pair of models, $HighComp$ is equal to one if the total household income per adviser is below the median. $Commissions$ is an indicator equal to one if a dual-registered investment adviser works under a firm that earns commissions during that month. $DualReg$ is an indicator equal to one if the adviser is dual-registered during the sample period. $Post$ is equal to one for the period following the merger. Coefficient estimates are scaled by 10,000. The unit of observation is an adviser-month. All of the regressions include individual and merger-by-month fixed effects. Standard errors are clustered at the merger level. Parentheses display t-statistics. Significance levels are indicated as follows: $^{*} = 10\%$, $^{**} = 5\%$, $^{***} = 1\%$

Outcome: *All Misconduct*

Competition Measure	Number of Advisers		Total Household Income per Adviser	
	HighComp	*LowComp*	*HighComp*	*LowComp*
Independent Variables	(1)	(2)	(3)	(4)
$Commissions \times Post$	-1.369	5.922***	-2.406	5.720***
	(-0.83)	(3.16)	(-1.35)	(2.94)
$DualReg \times Post$	1.095	-1.308*	1.50	-4.004***
	(0.78)	(-1.18)	(1.20)	(-2.60)
$Commissions$	-0.304	0.359	0.143	-0.735
	(-0.27)	(0.36)	(0.12)	(-0.50)
$DualReg$	-1.577*	-2.395***	-1.727*	-2.650**
	(-1.71)	(-2.86)	(-1.73)	(-2.33)
Merger $\times$ Month FEs?	Yes	Yes	Yes	Yes
Clustering	Merger	Merger	Merger	Merger
N	1,976,616	1,965,588	1,824,033	1,822,174
R^2	0.002	0.002	0.002	0.001

Table 6b: Competition and Commission-Related Misconduct

This table presents estimates from the triple difference regressions separated using measures of local competition. The dependent variable is equal to one if the financial adviser had a misconduct claim initiated against him/her in that month. In first pair of models, $HighComp$ is equal to one if the number of advisers in a zipcode is above the median. In the second pair of models, $HighComp$ is equal to one if the total household income per adviser is below the median. $Commissions$ is an indicator equal to one if a dual-registered investment adviser works under a firm that earns commissions during that month. $DualReg$ is an indicator equal to one if the adviser is dual-registered during the sample period. $Post$ is equal to one for the period following the merger. Coefficient estimates are scaled by 10,000. The unit of observation is an adviser-month. All of the regressions include individual and merger-by-month fixed effects. Standard errors are clustered at the merger level. Parentheses display t-statistics. Significance levels are indicated as follows: $^{*} = 10\%$, $^{**} = 5\%$, $^{***} = 1\%$

Outcome: $Misrepresentation$

Competition Measure	Number of Advisers		Total Household Income per Adviser	
	$HighComp$	$LowComp$	$HighComp$	$LowComp$
Independent Variables	(5)	(6)	(7)	(8)
$Commissions \times Post$	-1.491***	8.606***	-1.000***	5.259***
	(-3.26)	(3.92)	(-3.03)	(3.33)
$DualReg \times Post$	-0.640	-0.522	-0.393	0.142
	(-0.89)	(-0.62)	(-0.79)	(0.18)
$Commissions$	-1.016	-0.937	-0.465	-1.095
	(-1.50)	(-1.52)	(-1.33)	(-0.91)
$DualReg$	-0.889*	-1.111**	-1.727*	-2.540***
	(-1.68)	(-2.08)	(-1.73)	(-2.75)
Merger $\times$ Month FEs?	Yes	Yes	Yes	Yes
Clustering	Merger	Merger	Merger	Merger
N	1,976,616	1,965,588	1,824,033	1,822,174
R^2	0.002	0.003	0.002	0.002

Table 7: Adviser Experience, Commissions, and Misconduct

This table presents estimates from the triple difference regressions separated using measures of adviser experience. The dependent variable is equal to one if the financial adviser had a misconduct claim initiated against him/her in that month. $HighExp$ represents the subset of advisers with above-median industry experience, measured from the first date they appear in the data. $LowExp$ represents the subset of advisers with below-median industry experience. $Commissions$ is an indicator equal to one if a dual-registered investment adviser works under a firm that earns commissions during that month. $DualReg$ is an indicator equal to one if the adviser is dual-registered during the sample period. $Post$ is equal to one for the period following the merger. Coefficient estimates are scaled by 10,000. The unit of observation is an adviser-month. All of the regressions include individual and merger-by-month fixed effects. Standard errors are clustered at the merger level. Parentheses display t-statistics. Significance levels are indicated as follows: $^{*} = 10\%$, $^{**} = 5\%$, $^{***} = 1\%$

Outcome	*All Misconduct*		*Misrepresenation*	
	LowExp	*HighExp*	*LowExp*	*HighExp*
Independent Variables	(1)	(2)	(3)	(4)
Commissions × Post	4.772*	2.375	6.301***	0.257
	(1.92)	(1.17)	(3.01)	(0.12)
DualReg × Post	-4.524***	-5.350***	-5.594***	-2.067
	(-2.78)	(-2.64)	(-3.26)	(-1.19)
Commissions	-0.580	2.479***	-0.924	0.603
	(-0.32)	(2.19)	(-0.61)	(0.49)
DualReg	-1.539*	-2.395***	-2.606**	-1.596
	(-1.74)	(-2.86)	(-2.21)	(-1.58)
Merger × Month FEs?	Yes	Yes	Yes	Yes
Clustering	Merger	Merger	Merger	Merger
N	1,663,652	1,482,633	1,663,652	1,482,633
R^2	0.002	0.001	0.002	0.001

Table 8: Gender, Commissions, and Misconduct

This table presents estimates from the triple difference regressions separated using measures of adviser experience. The dependent variable is equal to one if the financial adviser had a misconduct claim initiated against him/her in that month. *Male* (*Female*) represents the subset of advisers with male (female) names based on the Genderchecker database. *Commissions* is an indicator equal to one if a dual-registered investment adviser works under a firm that earns commissions during that month. *DualReg* is an indicator equal to one if the adviser is dual-registered during the sample period. *Post* is equal to one for the period following the merger. Coefficient estimates are scaled by 10,000. The unit of observation is an adviser-month. All of the regressions include individual and merger-by-month fixed effects. Standard errors are clustered at the merger level. Parentheses display t-statistics. Significance levels are indicated as follows: $^* = 10\%$, $^{**} = 5\%$, $^{***} = 1\%$

Outcome	*All Misconduct*		*Misrepresenation*	
	Male	*Female*	*Male*	*Female*
Independent Variables	(1)	(2)	(3)	(4)
Commissions × *Post*	3.481	2.505	3.988**	2.060
	(1.56)	(1.30)	(2.07)	(1.37)
DualReg × *Post*	-3.602*	-3.307**	-3.764**	-2.476**
	(-1.96)	(-2.07)	(-2.37)	(-1.98)
Commissions	-3.795***	-2.495**	-4.131***	-2.935***
	(-2.61)	(-2.04)	(-3.29)	(-3.08)
DualReg	-0.593	-2.739***	-0.235	-2.990***
	(-0.50)	(-2.80)	(-0.23)	(-3.92)
Merger × Month FEs?	Yes	Yes	Yes	Yes
Clustering	Merger	Merger	Merger	Merger
N	1,712,516	849,064	1,712,516	849,064
R^2	0.002	0.002	0.002	0.002

Table 9: Commissions and Damages in Misconduct Cases

This table presents estimates from OLS estimates of damages conditional on a misconduct event occuring. The dependent variable equals the damages paid/requested in a completed customer dispute that is either ruled or settled in favor of the client. Dependent variables are winsorized at the 1st and 99th percentile. Independent variables are indicators for the firm's compensation policy during the month. AUM is the firm's reported assets under management in thousands of dollars. $AvgAcctSize$ is the firm's reported average account size reported in Form ADV. Coefficient estimates are in US dollars. The unit of observation is a disclosure event. Parentheses display t-statistics. Significance levels are indicated as follows: * = 10%, ** = 5%, *** = 1%

Compensation Type	Damages Paid		Damages Requested	
	(1)	(2)	(3)	(4)
$Commissions$	24,243.90**	25,013.36***	94,271.97***	96,556.12***
	(2.45)	(2.62)	(3.54)	(3.57)
AUM		0.20***		0.19***
		(12.90)		(4.20)
$AvgAcctSize$		-14.00***		-30.91***
		(-2.35)		(-2.74)
$Constant$	68,217***	60,341***	94,271***	188,517***
	(2.45)	(42.48)	(7.92)	(46.95)
Adj. R^2	0.000	0.006	0.000	0.001
N	32,067	30,875	32,067	30,875

Table 9: Changes in Fraud around the United Kingdom Commission Ban

This table presents estimates from the difference-in-differences regressions around changes to commissions and fees caused by the Retail Distribution Review's amendments to COBS 6.1A.4 R RP (COBS). The sample includes individuals registered as financial professionals on the Financial Conduct Authority's Register for at least 12 months before and after the implementation of COBS. Dependent variables are measures of misconduct that are equal to one if the individual received one or more misconduct disclosures in a year. Treated groups are individuals who held a customer function (CF30) over the event window. $Post$ identifies post COBS observations. The DID estimator is the coefficient of $Treated \times Post$. The unit of observation is an individual-year. Coefficient estimates are scaled by 10,000. The standard errors are clustered at the individual level. Parentheses display t-statistics. Significance levels are indicated as follows: $^* = 10\%$, $^{**} = 5\%$, $^{***} = 1\%$

Independent Variable	(1)	(2)
$Treated \times Post$	-0.911***	-0.907**
	(-3.64)	(-2.56)
$Treated$	0.716***	
	(4.96)	
$Post$	0.759***	
	(3.78)	
Individual FEs?	No	Yes
Year FEs?	No	Yes
Firm FEs?	Yes	Yes
Clustering	Individual	Individual
# of Clusters	417,332	417,332
N	3,074,598	3,074,598
R^2	0.1021	0.1689