

Who Should Regulate Investment Advisers?

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Abstract

We compare the ability of state and federal regulators to deter misconduct by investment advisers. Dodd-Frank shifted oversight responsibility for mid-size firms (\$25M-\$100M in assets) from the SEC to state-securities regulators for exogenous reasons. We find that client complaints increased 60% for mid-size advisers, relative to similar advisers continuing under SEC oversight. Complaints increased more in states with less-staff-per-adviser. Advisers with histories of misconduct, serving older and less-educated clients, and located farther from regulators misbehaved more. Severity increased as awarded damages doubled and denial rates dropped 10%. The results suggest state regulators deter less misconduct, especially against less-sophisticated clients.

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1 Introduction

Many individuals rely on advisers when making important financial decisions. In 2015, investment advisers oversaw \$66 trillion in assets, and the most recent 2013 Survey of Consumer Finances finds 58% of American households are a customer of some investment adviser.¹ Advisers have a fiduciary duty to act in a client's best interests. However, a recent landmark paper by Egan et al. (2017a) documents that a surprisingly large fraction of advisers, 1 in 5, frequently engage in misconduct. Misconduct has direct financial consequences on clients and lowers general trust in the financial sector. One might expect market forces would eliminate misbehavior, but instead, Egan et al. (2017a) find markets appear to tolerate misconduct. Not only are misconduct rates high, many advisers are repeat offenders. While 50% of advisers lose their jobs after misconduct, 44% of terminated advisers find work within the industry in one year. Many factors may contribute to this market failure. Customers often do not have the financial sophistication to monitor their adviser's decisions effectively, and the fiduciary standard advisers are held to is not exhaustively defined. Thus, regulators may be instrumental in deterring financial misconduct. Oversight of investment advisers is currently divided between a national regulator (the Securities and Exchange Commission) and state regulators, with the SEC overseeing larger and more complex firms (RIAs).

This paper seeks to understand the relative effectiveness of national and state regulators at deterring misconduct by investment advisers. A national regulator may have superior human capital, organizational practices, and visibility. In contrast, a state regulator may have better soft information and be more accessible to local constituents. Which regulator is better is an empirical question. In general, assessing the relative performance of regulators is challenging because oversight responsibilities rarely change, and when shifts occur, laws tend to change as well.

A unique opportunity to answer this question arose when the Dodd-Frank Act shifted the regulatory landscape, re-assigning a subset of RIAs from SEC oversight to state oversight. More specifically, Dodd-Frank mandated that the SEC transfer oversight of "mid-sized" RIAs (\$25M-100M in assets under management (AUM)) from the SEC to state regulators, except

¹This fraction rises to 75% for households with over \$100,000 in investable assets.

for RIAs located in Wyoming and New York.² This shift occurred quickly, being announced on July 21, 2011, and in effect by January 1, 2012. The size threshold of \$100M AUM was likely chosen because the threshold conveniently reversed a piece of the 1996 National Securities Market Investment Act (NSMIA).³ The objective of the shift was to offset SEC resources newly dedicated to oversight of hedge funds and private equity firms. Therefore, we argue the shift was exogenous to the behavior of advisers working at mid-size RIAs. Also, the states and Dodd-Frank did not alter the legal fiduciary standard advisers are held to. This re-jurisdiction affected over 38% of all existing SEC-registered RIAs.

Using a difference-in-differences design, we study how a shift from SEC to state regulator oversight affects misbehavior rates by investment advisers. We measure misbehavior using publicly available customer complaints filed against investment advisers. Complaints capture client dissatisfaction with an adviser's behavior. The shift in oversight did not substantively change the process of filing a complaint, which may be submitted anonymously online for free.⁴ We do not examine changes in the number of regulatory actions against advisers, as these actions may be due to shifting regulatory requirements rather than adviser misconduct. Data on the returns advisers earn clients are rarely available and may be confounded by clients' risk preferences. Using the complaint data, we construct a survivorship-bias-free panel data set at the individual-year level for the years 2009 to 2014.⁵ We assemble these data using a variety of required regulatory disclosures, including nearly 500,000 documents containing full employment histories for individual advisers and all disciplinary and regulatory disclosures. We also gather firm-level annual filings for every RIA, obtained through the Freedom of Information Act, and we hand collected budget data for every state.

Our main finding is that complaint rates increased by 0.5 percentage points per year due to the re-jurisdiction, relative to the complaint rate of the control group. This increase is 60% of the complaint rate of the control group in our sample. The increase in complaints was driven by increases in fraud, misrepresentation, and unauthorized activity and not by an increase in

²Wyoming had no registration requirements for investment advisers at the time, and New York does not examine investment advisers.

³NSMIA had assigned mid-size advisers to the SEC as part of a broader effort to unify state-securities regulations.

⁴Clients must visit their respective state securities regulator's website.

⁵In this paper, "advisers" refers to individuals, and "RIAs" refers to firms.

frivolous charges. The severity of the complaints increased: awarded damages doubled and denial rates declined 10%.

There are two competing explanations for the observed rise in complaints for treated advisers. On the one hand, under the “misconduct hypothesis,” actual misconduct may have increased because state regulators are less effective at deterring misbehavior than the SEC. On the other hand, under the alternative hypothesis, the probability of clients detecting misconduct may have increased. Detection rates may have increased if clients believe state regulators are more concerned with local misconduct or more capable of investigating local misconduct than a national regulator.

Cross-sectional variation in the treatment response overwhelmingly supports the misconduct hypothesis. First, if clients view state regulators as being more capable of addressing local misconduct, then we would expect the rise in complaints to be stronger in better-equipped states with higher regulator-staff-to-RIA ratios. We find *instead* that the treatment effect is highest in states with the lowest regulator-staff-to-RIA ratios. Second, state regulators would have needed budget increases to maintain a similar quality of oversight after the new mandate to oversee mid-size advisers. We find that states did not increase resources devoted to the state’s regulatory department as states were fiscally constrained in 2012. Third, if clients view state regulators as more accessible, then complaints should increase the most for advisers located physically closer to the state regulator. Instead, complaints increased the most for advisers located farther from the state regulator. A standard-deviation increase in distance to the regulator resulted in a 50% greater treatment response.⁶ Fourth, if complaint rates depend on how attentive state regulators are to local misconduct, then when the workload of state regulators increases, the complaint rates of always-state-registered small-size RIAs should decrease. Instead, clients of small-size RIAs complain more, consistent with advisers increasing misconduct.

We also consider cross-sectional differences in recidivism rates. If detection rates increased, we would expect advisers with histories of misconduct to reduce misbehavior. Instead, we find that advisers with more past complaints saw the greatest increases in customer complaints.

⁶This finding is robust to a variety of fixed effects that account for how distance may be correlated with local, time-varying economic conditions around where the RIA is headquartered.

Advisers with histories of misconduct who were treated are 5 percentage points more likely to misbehave than advisers with past misconduct who were not treated, which represents a 50% increase in misconduct relative to the misconduct rates for the untreated RIAs.

We also consider whether the treatment varies with cross-sectional differences in the sophistication of an RIA's clients. On the one hand, sophisticated clients are more likely to be aware of the shift in regulatory oversight, and thus, should respond more to changes in regulatory competence. On the other hand, sophisticated clients are better able to monitor advisers so that regulators may be less important. Using population data for a client's community, we find complaints increased more for advisers working in counties with less educated and older populations. Using client-type data reported by RIAs in Form ADVs, we also find the treatment effects are lower among advisers serving more sophisticated clients.⁷

Altogether, the cross-sectional tests point to greater misconduct rather than increases in the probability of detection. These findings contribute to the literature in two ways. First, we contribute to the large literature on the optimal design of financial regulation.⁸ The paper most relevant to ours is Agarwal et al. (2014), who study rotating state and federal supervisors of banks. They find that federal supervisors are harsher, which is consistent with our findings that the SEC appears to be better than state regulators at deterring financial misconduct by investment advisers.⁹ Both of our findings speak more broadly to potential coordination failures between national and state regulatory agencies. This evidence is especially important given the two centuries-long Federalism debates regarding division of responsibilities between local and national governments.

Second, we contribute to the small but rapidly growing literature on financial advising. Our findings that regulators help deter misconduct particularly for less-sophisticated clients complements the adviser literature on the importance of trust. Less-sophisticated clients depend on the ability to trust an adviser to help participate in markets and search for the optimal

⁷These findings rule out one alternative, which is that clients may be optimally responding to weaker state regulators by monitoring advisers more closely.

⁸Gopalan et al. (2016) is a recent paper that discusses closures of local field offices regulating banks, suggesting branch closures enable increased risk-taking. Karolyi and Taboada (2015) and Houston et al. (2012) study regulatory arbitrage in cross-border banking. Kondo (2014, 2016) study FINRA as a self-regulatory body and document the role of conflicts of interest and competition between regulators, respectively.

⁹Unlike in Agarwal et al. (2014), regulatory arbitrage is less relevant in our context, as the impact of our regulatory change is meant to be permanent, and the low lead time to implementation reduces concerns about partial anticipation.

investment portfolio. For example, Gennaioli et al. (2015) theorize that client participation in markets is enhanced by the trusted guidance of an adviser. Using a panel of Canadian advisers, Foerster et al. (2017) find that advisers do increase risk-taking by clients, raising expected returns; however, they find limited evidence of customization of advice to clients' risk preferences. The finding that advisers often provide sub-par advice is echoed in a field survey by Mullainathan et al. (2012) and archival studies by Chalmers and Reuter (2013) and Hackethal et al. (2012). Interestingly, requiring consideration of client suitability may reduce bad advice, as found by Chang et al. (2015).

When trust is damaged, market participation decreases. Gurun et al. (2017) find communities more affected by the Madoff scandal withdrew more money from advisers, consistent with lower trust. Also, damaged trust likely affects the search costs less-sophisticated clients face. Chang and Szydlowski (2016) theorize that high adviser fees constitute a fee for information provision, with unsophisticated clients paying higher fees. Advice from brokers may also be conflicted. For example, Egan (2017) demonstrates that brokers are able to issue dominated products with identical payoffs, suggesting that customers face search frictions and brokers can on average earn 1.2% higher fees as a result.

This paper also makes an impact on the new literature on adviser misconduct. Dimmock et al. (2017) study the peer effects of investment adviser fraud after RIAs merge. Egan et al. (2017a) document widespread misconduct and recidivism in the investment adviser industry and suggest market incentives and RIA governance alone do not seem sufficient to eliminate misconduct. Interestingly, Egan et al. (2017b) find that female advisers are more likely to be punished for misconduct, despite engaging in less costly misconduct and despite a lower propensity towards repeat offenses. The prevalence of misconduct and high recidivism suggest clients are unable to resolve agency problems. These findings motivate our results showing the role regulators have in deterring misconduct, in particular for less-sophisticated clients.

Finally, our results are also of significant interest to recent policy discussions re-evaluating Dodd-Frank, and to debates regarding the controversial Department of Labor's expansion of the fiduciary standard to brokers. Our results suggest proper coordination and division of responsibility among regulators is likely to affect outcomes for investors.

2 Background on Investment Advisers

2.1 History of Regulatory Jurisdiction

In the United States, investment advisers are regulated under the Investment Advisers Act of 1940 (Advisers Act). The Advisers Act holds investment advisers to a fiduciary standard, requiring them to act in their clients' best interests. The legal definition of an investment adviser is broad: an adviser is "*any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or, who for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities,*" except when "*solely incidental.*"¹⁰ In addition to providing securities advice, investment advisers may manage investment portfolios, provide financial advice, and offer brokerage services (e.g. buying or selling stock or bonds).¹¹ Usually, an investment adviser firm has several investment companies (mutual funds, closed-end funds, unit investment trusts, private funds), and in turn each investment company could offer several different funds. Thus, common names for investment advisers include asset managers, investment counselors, investment managers, portfolio managers, and wealth managers. In this paper, we will term investment adviser firms as "RIAs" and the individuals employed as "investment advisers."¹²

Regulatory oversight of RIAs is divided between the SEC and state regulators. Prior to 1996, the SEC oversaw RIAs managing more than \$100 million in AUM and state regulators oversaw RIAs with less than \$100 million in AUM. The National Securities Markets Improvement Act of 1996 (NSMIA) folded mid-size advisers (\$25-\$100 million AUM) into SEC jurisdiction, as part of a collection of efforts to integrate national securities regulations. Since NSMIA circumscribed state authority, state securities regulators have been aspiring to reclaim their

¹⁰"Solely incidental" in laymen terms is meant to characterize those whose course of business contains content that could be construed as investment advice, but not for the purpose of giving such advice. Business school professors in finance, for instance, do not have to register as investment advisers if discussing efficient market theory or teaching CAPM.

¹¹Six years prior to the Investment Advisers Act of 1940, Congress wrote into law the Securities Exchange Act of 1934, which defined a broker-dealer as "any person or company engaged in the business of buying and selling securities on behalf of its customers, for its own account (as dealer) or both."

¹²RIA employees are also known as investment adviser representatives.

oversight authority. Executive Director Russ Iuculano of the North American Securities Administrators Association (NASAA) stated, “The financial catastrophe of 2008 gave NASAA a great opportunity to make its case that our system of financial services regulation must be strengthened, but only through the combined efforts of state and federal regulators.”

The most recent shift in oversight responsibility resulted from the Dodd-Frank Act. Section 410 of the Dodd-Frank Act shifted oversight of mid-size advisers (\$25-\$100 million AUM) back to the states. While Dodd-Frank was signed into law in July 2010, the shift was not publicly announced until July 21, 2011, and went into effect by January 1, 2012. The primary motivation for this change was that Title IV of the Dodd-Frank Act repealed the “private adviser” exemption, which had exempted hedge funds, private equity firms, and venture capital firms from registering with the SEC. Raising the AUM threshold freed up SEC resources to monitor this new cohort. The Act did not shift oversight of RIAs in Wyoming and New York.¹³ Figure 1 depicts the timeline of the events.

[Figure 1 about here]

At the time of the law’s announcement, the SEC estimated that 3,200 RIAs would be delegated to examination by state law. As of 2011, the SEC reported that 3,512 RIAs had filed with between \$25 million and \$90 million in regulatory AUM, and about 300 of these RIAs would be exempt for other reasons, such as being foreign.

Because investment advisers often help implement their advice, almost 90% of investment advisers are also registered as broker-dealers as of 2012 and under the oversight of FINRA. Oversight by FINRA did not change as a result of the Dodd-Frank Act. Brokers are not held to a fiduciary standard but rather to a “suitability” standard of conduct.¹⁴ Another key difference between brokers and investment advisers is that brokers typically receive commissions and product fees while investment advisers earn fees based on AUM. These differences in compensation incentives may lead to conflicts of interest and thus outcomes that are not in a client’s best interests if clients do not understand when their adviser is acting as a broker or

¹³RIAs in Minnesota were also not subject to the shift in oversight until 2011, when Minnesota decided to establish an RIA examination program.

¹⁴The suitability standard requires a broker who recommends buying or selling a security to consider a client’s income and net worth, investment objectives, risk tolerance, and other security holdings. In 2017, for certain activities, the Department of Labor has raised the standard from suitability to fiduciary duty.

investment adviser.

2.2 Disclosure Requirements for Investment Advisers

Investment advisers and broker-dealers are generally required to maintain updates with regulators of any material events that regulators, clients, or employers may find relevant. Beyond regulatory events and customer complaints, required updates include disclosures of personal bankruptcy, civil suits, or liens on their personal assets. Once these disclosure events are made to regulators, the profiles of RIAs and investment advisers are updated in public databases.

Our workhorse variable is the number of complaints initiated by customers, regardless of their statuses, including complaints that are in progress, settled, denied, or withdrawn.¹⁵ We keep all complaints in order to test both changes in complaint activity and outcomes.¹⁶ More specifically, we are interested in whether client complaint activity differentially increased for clients of RIAs that shifted from SEC to state oversight, relative to similar RIAs continuing under SEC oversight. Having found a significant increase in complaints, we then test for changes in the dollar value of alleged damages and the propensity for the case to be settled versus denied.

How costly is filing a complaint? Filing a complaint requires no fee, and complaints are filed electronically. Of course, clients do incur costs in other ways; carrying through with complaints takes time, can lead to alienating a relationship with an existing adviser, and reclaiming damages through arbitration or settlement requires processing fees, as well as potential legal costs. Figure 3 shows the electronic procedure for filing complaints for the state of New Jersey. Methods for other states are nearly identical.

[Figure 3]

¹⁵Customer complaints in BrokerCheck may undergo a variety of status updates. Complaints that are executed fully are often arbitrated through FINRA's arbitration process or processed by some other formal procedure.

¹⁶This variable is different from the measure of misconduct used in Egan et al. (2017a), who consider the category, "Employment Separation After Allegations" to be part of misconduct, and ignore the category "Customer Dispute - Denied," as well as other customer disputes. Their purpose is to identify misconduct of any kind, whereas ours is to identify misconduct specifically from the perspective of customers. To the extent our consideration of denied complaints could drive our results, in Section 5, we analyze the propensity for a complaint to be denied.

3 Data & Methodology

3.1 Investment Adviser Data

Data for this study come from two sources: Form ADV filings and the Investment Adviser Public Disclosure (IAPD) database. Form ADV is filed annually or upon important business updates and indicates details of an RIA’s registration - where the RIA operates, management, and basic details about the business operations. We filed a Freedom of Information Act request with the SEC to obtain the universe of SEC-registered Form ADV filings for the years 2000 to 2015.¹⁷ We identify firms that switched from SEC oversight to state oversight in 2012 using Form ADV-W filings, which indicate a partial de-registration filed with the SEC. A partial de-registration indicates the RIA is continuing to operate but under state oversight. A full de-registration indicates an RIA ceases to operate.

We also retrieve the disclosure histories of investment advisers from the IAPD, which the SEC maintains. The IAPD draws from the Central Registration Depository (CRD) database, which is maintained by FINRA.¹⁸ We obtain these detailed disclosures from the IAPD using a web-scraper that takes a representative’s CRD number and queries the IAPD website. We query all CRD numbers between 1 and 10 million to get the universe of investment advisers.¹⁹ For each adviser, the IAPD stores all data, including complaints with alleged damages for at least 10 years. Preserved disclosures include customer complaints, criminal actions, regulatory actions, litigation, terminations, civil suits, and other financial matters, such as liens, that might be pertinent to an adviser’s ability to manage money. Often, the customer complaints will contain a product code. For example, 20% of complaints dealt with stocks and 4% with over-the-counter securities. The complaint data contain unstructured text detailing the

¹⁷The full universe of Form ADV filings would consist of firms registered with state regulators and would require issuing FOIA requests to every state regulator, or purchasing from a vendor who has done the same. For this study, the full universe is not essential.

¹⁸Data for brokers is disseminated through BrokerCheck, which FINRA maintains. As noted in Egan et al. (2017a), BrokerCheck covers all brokers (around half of brokers are not investment advisers) and the vast majority of investment advisers. The difference between the two sources is that about 70,000 investment adviser representatives never registered as brokers and are thus not in FINRA’s database. In the original version of this paper, we used data from BrokerCheck and achieved quantitatively similar results.

¹⁹We use open-source software to extract details from the queried pdf for each adviser. We extract all fields and normalize across complaint types. The two difficulties are that the field names and data are hand-entered and therefore must be cleaned, and that the different disclosure types have different names for what is effectively the same field (date litigation filed, date complaint received). After this process, we extract the disclosure and assign a date to it.

nature of the allegation from the different participants (e.g., regulator, adviser, client), as well as docket identifiers to track legal proceedings related to a case.

We use the data to construct a person-year panel data set, containing the employing firm, all complaints received, and other individual characteristics. In each representative's detailed reports from the IAPD, we see the representative's full employment history at the branch level, including start and end dates.²⁰ Similar to the prior literature, we assign a complaint to the year the complaint was officially received by the CRD. We drop about 7% of disclosures that do not include the date received. We also observe other individual characteristics, such as professional designations and exams passed (Series 66, Series 63, Series 65). For our analysis, we restrict the advisers to be ones employed at the end of 2014. About 12% of person-year observations available from 2009-2014 involve people leaving the industry by the end of 2014. The vast majority of people who leave firms leave for reasons unrelated to misconduct. When we include these individuals for analysis, our results are quantitatively similar and more precise due to increased observations. Diagnostic tests suggest that advisers who leave do not seem to exit the sample more frequently whether they are treated or untreated, both unconditionally and conditional on a complaint. Thus we argue survivorship bias is not an issue.

Finally, we also hand-collect data on financial regulator budgets for each state. For all states, we are able to capture the budget back to 2009. However, the data is at different granularity. In some states, there is an identifiable division devoted to adviser enforcement. For some other states, the regulatory efforts are commingled with other functions, such as oversight of banks, insurance, or consumer financial products. That said, within the state, we later present graphical evidence on how state regulator budgets evolved, which one would assume may increase as their workload increased. However, these data are not suitable for a direct cross-sectional comparison given the data arises from different levels of granularity.

²⁰This data are apparently maintained by hand. Sometimes branch locations are misspelled (e.g. ATALANTA, ATLNTA, representing ATLANTA). We normalize the names and remain conservative in grouping branches. For our analyses, this is conservative because an extra branch fixed effect would simply chip away from our point estimates of interest. The second unrelated data issue is that in less than 0.25% of individual years, advisers belong to more than two RIAs, owing evidently to cases where the RIA has multiple CRD numbers assigned. In these cases, we defer to the first method, which assigns individuals to one RIA at a point in time, or assigns the individual to the firm CRD most commonly seen in the sample.

3.2 Methodology

We hypothesize that state regulators are less able to deter misconduct than the SEC. The SEC likely attracts higher-human-capital staff and has more experience auditing larger and more-complex RIAs. Alternatively, state regulators may have a local information advantage. However, because state regulators had not monitored mid-size advisers for the prior 15 years, the local-information advantage may be small.

To test the hypothesis, we use the following empirical specification:

$$1\{\text{Complaint}\} = \alpha + \beta_1\text{Treated} + \beta_2\text{Post}^{2012} + \beta_3\text{Post}^{2012} \times \text{Treated} + \varepsilon_{it}$$

where the coefficient of interest is β_3 . The outcome variable is the probability of receiving a complaint (extensive margin). We also examine the effect on the log amount of alleged damages, awarded damages, and denial rates (intensive margin).²¹ The specification uses a difference-in-differences design using a person-year panel for the period 2009 to 2014. In robustness, we find similar results using the collapsed-three-year-window approach of Bertrand et al. (2004) and using the annual window. We prefer the annual panel for the main specification because individuals may move across RIAs and we can better control for trends.²² The main specification uses the person-year data set and includes RIA and year fixed effects. We cluster standard errors at the state level.²³

3.3 Identifying Treatment and Control Groups

We label RIAs as “treated” if their 2011 AUM is below \$100 million, the RIAs file a Form ADV-W indicating partial de-registration, and the RIAs are located in the affected states (all but New York and Wyoming).²⁴ The SEC projected around 3,200 RIAs would be affected in 2011. Since 2011, the bull market in equities increased the AUM of RIAs, so that in October

²¹Alleged damages are not associated with every complaint. Additionally, the record-keeping agent may not properly populate the field.

²²The collapsed-three-year window around 2012 may have more power as complaints may not be filed immediately when the misconduct occurs. Another advantage of the collapsed-window approach is that the serial correlation of residuals do not mislead inferences. Shortening the window to two years does not affect the inference.

²³We also cluster at the RIA level, and the significance does not change.

²⁴Full de-registration implies a business cessation or change of ownership.

2012, the SEC stated that “over 2,300” RIAs made the switch.²⁵ We identify 2,316 treated RIAs, suggesting that we identify well the treated RIAs. Figure 2 shows a large increase in Form ADV filings in 2012. The increase in ADV-W filings drove the spike.

3.4 Summary Statistics

Table 1 displays the breakdown of observation counts for various subsets of the data. We start with 4.6 million person-year observations. We limit the sample to the time period 2009 to 2014. The resulting sample contains 1,791,522 person-year observations across SEC and state-registered advisers. We further limit the sample to RIAs that were SEC registered in 2011 - one year before the Dodd-Frank Act, which results in 1.29 million person-year observations.

[Table 1]

Table 2 presents summary statistics at the RIA level. The number of treated RIAs and untreated RIAs is 2,316 and 3,910 respectively, which suggests the change influenced more than a third of RIAs under SEC oversight prior to the shift. Along several dimensions, treated and untreated RIAs are similar. Both types of RIAs are equally likely to report having investment discretion and proprietary conflicts of interest.²⁶ However, compared to non-treated RIAs, treated RIAs are less likely to have custody of assets, less subject to independent audits, less likely to be private funds, less likely to recommend an external broker, and more likely to serve individuals and unsophisticated individuals. These compositional differences in RIA characteristics justify including firm fixed effects in our specifications. In some specifications, we go further and include individual fixed effects. To further ease the concern that treated and untreated RIAs are different, we construct a matched-sample comparison designed to maximize the similarity between individuals and employing RIAs; we compare mid-size RIAs in treated and untreated states (NY and WY); and we restrict the sample to RIAs with assets close to the treatment threshold of \$100 million.

[Table 2]

Table 3 presents information on complaints before and after the Dodd-Frank Act. Panel A

²⁵See <https://www.law360.com/securities/articles/388275/sec-counts-1-500-fund-advisers-registered-under-dodd-frank>

²⁶Potential proprietary conflicts of interests arise when an RIA and client trading incentives may differ.

summarizes the nature of complaints. The sample probability of receiving a complaint is 1.25% for the full sample. Conditional on having alleged damages, the dollar amount of a complaint is significant with an average over \$200,000. Conditional on restitution, the amount of compensation is around \$200,000. The numbers on settlement and arbitration suggest about half of cases result in restitution. During the financial crisis, alleged damages were much higher. .

[Table 3]

Panel B in Table 3 presents complaints by product and allegation type. In terms of product, complaints most frequently involve variable annuities, mutual funds, and equities. Advisers may play a bigger role in client investments in these higher-risk products. In terms of allegation types, the most common complaints are for misrepresentation and lack of suitability. The explicit word “fiduciary” is present in about 7% of complaints, suggesting the client is alleging a violation of a broad fiduciary standard. The fourth largest category is “unauthorized,” also at around 7%, suggesting the adviser made a trade the client did not authorize. Fewer complaints allege “churning” and “fees.”

4 Results

4.1 Complaint Rates and Dodd-Frank

Table 4 presents two sets of results. Columns 1 to 3 report the annual sample results. Column 1 reveals that the average annual complaint rate is 0.8% in our sample for the control group. In the post period, advisers working at mid-size RIAs that shifted to state oversight (Treated) experience an increase in complaint rates of 0.53 percentage points (60% of the average annual rate for the control group) in the post period relative to RIAs that remain under SEC oversight. Column 2 adds RIA and year fixed effects, and Column 3 additionally adds individual fixed effects. The magnitudes appear stable as the fixed effects are added, suggesting unconditional differences in investment advisers and RIAs cannot explain our result. Columns 4 to 6 repeat the exercise using a two-period specification rather than an annual panel. Counting the complaints in the pre-period (2009 to 2011) and post-period (2012 to 2014), we find that

the treatment effect again points to an increase of 70%, relative to the three-year complaint rate of 2.5% for the control group.

[Table 4]

One concern is that large-size RIAs (Control) may not be comparable to mid-size RIAs (Treated). For example, the summary data reveal that large-size RIAs engage in somewhat different business practices with different clienteles. Although RIA and individual fixed effects remove unconditional differences between the treatment and control groups, the treatment and control groups may have different exposures to market conditions. Using annual person-year panels, Table 5 regression (3) compares untreated mid-size RIAs headquartered in New York and Wyoming with treated mid-size RIAs, and the results get stronger.²⁷ Another concern we address is that many RIAs are based in California and New York and may be different. In regressions (1) and (2), we exclude each state respectively and find no meaningful changes in our estimated effect. We also run a placebo test in regression (4) by specifying the treatment year as 2005 to have no overlap with our sample period of 2009 to 2014. The placebo shows no statistically significant results and the point estimate is negative.²⁸ Another way to ensure that we are comparing similar treated and untreated RIAs is to limit the sample to RIAs with similar AUMs. Appendix Table A.3 presents the results. Regressions (2) to (8) limit the RIA sample based on 2011 AUM. The effect persists and is stronger when we limit the sample to RIAs that are more similar in size.²⁹

[Table 5]

Another concern for a difference-in-differences specification is a violation of the parallel-trends assumption. To resolve this concern, we repeat the analysis using matched samples. For each investment adviser treated in 2012, we find a matching investment adviser. In the first matched sample in regression (5), we require investment advisers to have exact matches

²⁷The inferences are identical using a two-period panel. We also present a specification using branch*post fixed effects, which provides a fixed effect for every branch city by time period (treated, untreated) and our estimate remains large and reliable.

²⁸The 2003 to 2006 sample period is more than 10 years before we obtained the data. Because disclosures are maintained for a minimum of 10 years, there may be survivorship bias for this placebo test.

²⁹We do not use an RDD because we do not observe the AUM in 2012. We often only observe RIAs' 2011 ADV AUM for RIAs that switch to state oversight and thus cannot observe the forcing variable required for an RDD. Also, the discontinuity is not precise because existing SEC-registered RIAs do not need to deregister unless assets fall under \$90 million but new RIAs have to be above \$100 million to register with the SEC.

on four criteria: indicators for receiving a complaint in 2009 and 2010, the same total complaint count between 2009 and 2010, and working in the same state in 2012. The advisers are also matched on a propensity score of an RIA to be treated based on a vector of RIA characteristics. Note that we do not match on 2011 behavior - the year prior to the treatment year. The matched sample is done with replacement and standard errors are clustered at the match pair.³⁰ The matched sample regression shows a similar estimate of the treatment effect of 0.711-percentage-points. The result also holds, in regression (6), when we require exact matches on year-by-year complaint counts for 2009 and 2010 but relax the assumption that RIAs are in the same state. We also construct a parallel-trends graph, Figure 4, by matching investment advisers only on complaint activity in 2009 and 2010. We do not match on 2011 activity. The graph suggests no violation in the parallel-trends assumption as the matched samples have identical trends in 2011 and divergent trends on treatment in 2012.³¹

Taken together, we argue we have a robust finding: switching to state regulation resulted in a larger number of complaints for affected investment advisers.

4.2 Which Types of Complaints Increased?

Table 6 shows that the increase in complaints for treated investment advisers increasingly dealt with options, equities, and real estate. Equities and options are risky, complex, and informationally sensitive assets that are likelier to require the regular involvement of the investment adviser. We see null results for private placements, which are primarily products used by sophisticated clients, who are more capable of monitoring their advisers. There also is no evidence of an increase in complaints related to annuity products, which may be because annuities are buy-and-hold products with a long-term horizon. We do not see an increase in churn- or fee-related complaints as a result of treatment. One potential interpretation is that churn- and fee-related complaints are commonly broker-related complaints and oversight of

³⁰This follows the recommendation of Abadie and Speiss (2016) for clustering adjustments when control observations are drawn with replacement.

³¹In addition to the two main matching algorithms, we also considered other variants: using the same number of complaints total in history (instead of the pre-period), and forcing the same complaint *count* every year in the pre-period. All variants produce similar results that are sometimes stronger. Other restrictions such as forcing zero complaints in the pre-period provide a directionally similar estimate. We also tried matching without replacement, achieving very similar magnitudes.

brokers by FINRA did not change as a result of the Dodd-Frank Act. In contrast, fiduciary and unauthorized trading activity differentially increased after treatment. However, there are also very few churning and fee related complaints in our sample.

[Table 6]

We next examine changes in the rates of four other types of disclosures that are not customer complaints. Table 7 presents our results. Regulatory actions exhibit an increase for treated RIAs, but the magnitude is small and statistically unreliable. A relative increase in regulatory actions for the treated is likely due to required re-registration. Financial disclosures, criminal disclosures, and terminations (which could be initiated by the RIA or regulator) similarly are insignificant. The results suggest that treatment is not associated with these other types of disclosures. This provides additional suggestive evidence that regulator involvement does not explain our finding.

[Table 7]

5 Greater Misconduct or Better Detection?

We now examine whether the increase in complaints is due to more misconduct or better detection by clients and state regulators. To understand the alternative reasons why complaints may differentially increase as a result of the treatment, consider the following decomposition:

$$Complaint = \Pr(Detection) \times Misconduct + \Pr(False\ Positive) \times Normal\ Activity.$$

We might observe an increase in complaints for the treated group if the treated advisers misbehave more (*Misconduct* increases). Alternatively, we might observe an increase in complaints by clients if clients increase the probability of detection ($\Pr(Detection)$ increases). Perhaps, clients view state regulators as being more concerned with local misconduct or more capable than a national regulator. Also, we might observe an increase in complaints if clients are more likely to file frivolous complaints ($\Pr(False\ Positive)$ increases). To distinguish between these mechanisms that may explain an increase in complaints, we rely on cross-sectional tests.

5.1 Did Frivolous Reporting Increase?

Frivolous reporting may increase for a number of reasons. First, clients may perceive the cost of filing complaints with state regulators to be less expensive than filing with the SEC. There is no evidence that the actual cost of filing a complaint online changed, although a physical visit to the local office is less expensive. Second, clients may be opportunistic if clients perceive the state regulator to be more cooperative. To test for frivolous reporting, we examine whether the nature of complaints and the probability of a favorable award for a given severity changed with treatment. We extract three sets of fields: the dollar amount of alleged damages, the amount of monetary compensation (represented in the two fields settlement amount and monetary compensation), and whether the allegation was denied, withdrawn, settled outside of arbitration, or awarded in arbitration.

We first examine whether the severity of complaints increased using the alleged dollars of damages measure. On the one hand, if clients are complaining more, clients may be more willing to complain about smaller misconduct, represented by smaller dollars of alleged damages. On the other hand, if clients are complaining more and the dollars of alleged damages also increase, then misconduct may have also become severe. Alternatively, clients may be filing larger but more frivolous complaints, which should result in higher alleged damages but lower settlement awards. Table 8 regressions (1) to (4) show a positive effect of the shift on the dollars of alleged damages, with magnitudes suggesting a 20-66% increase in alleged damages; however, the point estimates are not statistically significant.³² Since all the coefficients are positive, there is no evidence in support of the first line of reasoning. Regarding the settlement rates, Table 9 Panel A shows that the log award and the probability of receiving an award significantly increases for cases involving advisers at the treated RIAs. This effect is robust to controlling for first, second, and third-degree polynomials of the log amount of alleged dollar damages, as the amount of award, or even the probability of getting one, should increase in

³²After inspecting the data closely, we observe that 1/4th of cases report alleged damages as zero. These fall into two cases: when the customer was awarded a settlement, and a case was denied as generally lacking merit or the case is no longer reportable. The presented results assume use the full data, except it edits the alleged damages to be at least the settlement amount when a non-zero settlement is reported and keeping alleged damages as zero when the case is denied. Another sampling choice is to completely remove these cases, under which our inference that alleged damages did not seem to fall is unchanged. A final sampling choice we made was to aggregate alleged damages by person-year as a handful of financial advisers receive many complaints in the same year. In this case, we can obtain more precise estimates that are significant under some specifications.

the magnitude of the allegation. This result does support the latter reasoning that complaints both increased and became more severe.³³

We next examine whether the probability of a complaint being denied changes for complaints against treated RIAs. If complaints are more frivolous, we would expect the probability of being denied to increase. Instead, Table 9 Panel B shows that the probability of being denied decreases for complaints against treated RIAs.

Overall, the results suggest complaints against treated RIAs increased in count, alleged damages, settlement amounts, and probability of award. Taken together, these three pieces of evidence do not suggest the more frequent complaints were frivolous. If anything, complaints became more *severe*.

[Table 8]

[Table 9]

5.2 Under-staffed State Regulators

States that are more financially constrained are less able to investigate and deter misconduct. In response, representatives may take advantage of a weaker regulator by misbehaving more. Figure 5 shows that although state regulators' workload increased significantly, on average states did not increase regulators' budgets. This suggests that despite the workload increase, state regulatory agencies could not, or neglected to, obtain resources to deal with an increased regulatory burden and the heightened complexity of mid-size advisers. To better identify the impact of regulator budgets on observed misconduct, we study heterogeneous treatment effects across states with different funding.

[Figure 5]

Our main measure of state-regulator resources is staff-per-adviser. To measure staffing, we use a report compiled in 1999 by the American Association of Retired Persons on the regulatory

³³This analysis experiences a drop in sample size because unlike in Table 8, we do not want to control for alleged damages in relation to settlement when we cannot observe the alleged damages. However, including these cases are immaterial to our inference.

differences for investment advisers in every state.³⁴ We argue the staff-per-adviser devoted to adviser regulation in 1999 is likely correlated with the current level of regulatory oversight. Because it is predetermined, it is not contaminated by reverse causality.³⁵ In some states, the number of staff-per-adviser is not available, attributable to the fact that the regulator is *not* devoted to adviser regulation only, but financial-services regulation overall.

Table 10 shows that states with higher staff-per-adviser saw a smaller treatment response, consistent with more staff at securities regulators deterring more misbehavior. The first two specifications impute a value of zero staff for those states with missing values. The last two columns drop states that may have no staff devoted specifically to adviser regulation, which does not qualitatively change the results. In unreported subsample analysis, we show just using mid-size RIAs (under \$100 million) yields identical inferences. Regressions (1) to (4) report nearly identical magnitudes. The standard deviation of the variable is 0.24. Counteracting the treatment effect therefore requires a two-standard-deviations increase above the mean of staff-per-RIA. We caution against interpreting this magnitude literally, because staff-per-adviser may be correlated with other mechanisms, but it would suggest staff resources are partly responsible for the observed increase in complaints.

[Table 10]

5.3 Distance to Regulator and Misconduct

This section examines cross-sectional variation in the misconduct rates of mid-size RIAs due to Dodd-Frank with distance to each RIA's regulator. On the one hand, clients of mid-size RIAs may have increased complaints because these clients view state regulators as being more cooperative than the SEC. If so, then the increase in complaints due to treatment should be greater for RIAs located closer to the state regulator. On the other hand, state regulators may monitor less often RIAs located farther from the state regulator. Distance may matter because RIAs located farther away require more commute time and other costs to monitor,

³⁴The American Association of Retired Persons has been long involved with consumer advocacy in the financial adviser industry. In addition to producing several reports for public consumption on the financial adviser industry, the AARP has also participated in regulatory discussions through several comment letters.

³⁵As part of this project, we tried surveying regulators today for the same numbers, but obtaining pre-2012 numbers was extremely difficult.

the regulators have less soft information about more distant RIAs, and the regulators may be less salient to more distant RIAs. Thus, investment advisers located farther away from the regulator may take more advantage of the regulator's weakness.

To measure distance, we use the longitude and latitude of the zip code of the branch where the investment adviser worked and the location of the adviser's branch, RIA headquarters, nearest SEC office, and nearest FINRA office. Distances are measured using zip-code coordinates from the 2013 Census, although we try other geocoding measures based on Google Maps and the Bing Maps API.³⁶

[Table 11]

Table 11 shows complaint rates increased more for mid-size RIAs located farther from their appropriate state regulator. Regression (1) shows a positive and significant coefficient on the interaction of treatment and distance using RIA and year fixed effects. An adviser twice as far from a regulator as another adviser has a 0.2-percentage-points-higher probability of receiving a complaint. Column 2 adds state-year fixed effects to account for within-state-time variation. Our estimate improves in magnitude and precision to 0.232. This is sensible because cross-state variation in urban density may confound the estimate of distance. Specifications (3) and (4) control for distance to FINRA and the SEC.³⁷ Column 5 and 6 example alternative fixed effect assumptions. In the final specification, the point estimates are robust to adding firm, state-by-year fixed effects, zip-code-by-year fixed effects, and adviser branch-by-year and adviser level fixed effects, controlling for distance from the closest SEC branch. Thus, we are comparing complaint rates against treated mid-size RIAs with untreated large-size RIAs in a zip code, accounting for any time-varying local conditions captured at the headquarter or branch at a given point in time.

Each specification also includes interactions on the relation between treatment and distance from the closest office of FINRA and the SEC. There is no consistent evidence that a mid-size

³⁶The distance measurements are quite similar and results are directionally and quantitatively similar.

³⁷We do not horse-race distance from the closest state, SEC and FINRA regulator simultaneously due to collinearity issues. As only a few states have SEC or FINRA branches, distance to the SEC and FINRA are 76% correlated. When run in the same regression, coefficients on distance to FINRA and SEC are significantly opposite of each other. This would be expected if the two variables are collinear. However, our main effect of interest (the cross-sectional effect of distance on treatment) obtains or strengthens in most of these specifications.

RIA's distance to an SEC-regional office explains differences in misconduct rates. The lack of a relation may be due to the small number of regional offices (eleven), and the SEC's focus on large-size RIAs. The distance from a FINRA branch also is not consistently related to the treatment effect. Although the estimate is unreliable, a positive relation is sensible: most advisers are dually registered with brokers, and therefore are partly under FINRA oversight. Moreover, although complaints may be initiated with a regulator, if the complaint enters arbitration, the arbitration is administered by FINRA. Therefore, the perceived or actual cost of regulatory enforcement may be greater for advisers further from FINRA branches.³⁸

5.4 Client Composition and Treatment Response

On the one hand, if clients perceive that state regulators are more cooperative than a national regulator, then we would expect more sophisticated clients to be more aware of the shift in regulatory oversight and more likely to increase complaints. On the other hand, if state regulators are weaker than the SEC, then we would expect investment advisers serving less sophisticated clients to increase misconduct more, because more sophisticated clients are better at monitoring advisers. We measure client sophistication in two ways and find evidence that client complaints increased more when RIAs served less sophisticated clients.

First, we assume client composition is correlated with the demographics of the county in which the adviser serves. Following Egan et al. (2017a), we look at client composition at the branch level. We obtain the branch location (city level) in which the individual adviser works and assign the adviser to a county based on the city name.³⁹ After doing so, we obtain county-level characteristics from various government sources. We use two versions of the American Community Survey. We use the 2011-2015 American Community Survey (ACS) as reported

³⁸Because investment advisers can move across different RIAs throughout the sample, we emphasize annual specifications for this result. Although we report results using a full annual panel, using the $\leq \$100\text{M}$ AUM adviser panel yields even stronger results in terms of point estimates. Two-period results point in similar directions, but are weaker unless taking into account the fact that adviser representatives move across RIAs. Finally, a purely cross-sectional test, wherein we control for treatment, past complaints, and $\log(\text{distance})$, we also find that there is a significant relation between $\text{Treated} \times \log(\text{Distance})$.

³⁹After cleaning branch-city names for misspellings, we assign the city name to all relevant zip codes. Where a branch-name could correspond to multiple counties, we conservatively assign the adviser representative to the largest county. The vast majority of adviser representatives report a branch. However, some observations are lost due to a lack of data, or a branch-city location that can not be disambiguated. In some cases, the adviser representative reports a branch location that is a state or an incomplete city name that does not correspond to a identifiable county.

by the U.S. Census Bureau. To ensure look-ahead bias is not contributing to our results due to the 2011-2015 sample overlapping the treatment in 2012, we also use the one-year ACS from 2012.

Table 12 reports our results. Columns 1 and 2 interact the treatment effect with county-level college degree attainment. It shows a standard-deviation increase in the county-level percentage of adults without college degrees increases treatment by 18.7 basis points, which is a 33% greater effect than the effect on the mean mid-size RIAs. Column 2 adds a branch fixed effect. Controlling for county-level unconditional variation *increases* the point estimate to 19.4 basis points. Column 3 reports results based on the 2012 survey. It suggests a similar result: a standard-deviation increase in the fraction of population with bachelor degrees decreases treatment by 23.2 basis points. Column 4 shows the treatment effect is greatest in counties with a larger fraction of elderly.

[Table 12]

We also examine how the treatment correlates with differences in RIA-reported client composition in the annual Form ADV. Individual investment advisers are not required to report their client compositions; only the firm (RIA) reports. Thus, we no longer have branch-level variation in client composition. The Form ADV provides the proportion of clients that are accredited (sophisticated individuals), un-accredited (unsophisticated individuals), government agencies, institutional investors, and private funds. Table 13 regression (5) shows that complaint rates against mid-size RIAs increased less in response to Dodd-Frank for mid-size advisers serving more institutional investors and government agencies. These clients are likely capable of monitoring investment advisers, and RIAs serving these clients may serve more sophisticated individuals in general.

[Table 13]

5.5 Recidivism

If we assume that misbehaving investment advisers are more likely to misbehave under a weaker regulator, then we expect advisers with greater histories of misconduct to respond more

to the treatment than advisers with no histories of misconduct. Under a stronger regulator, advisers with worse histories may reduce misbehavior more. We use the following empirical specification to test this hypothesis:

$$Complaint_i = \alpha + \beta_1 Past_i^{Complaint} + \beta_2 Treated + \beta_3 Past_i^{Complaint} \times Treated + \epsilon_{it}.$$

The variable $Past_i^{Complaint}$ is the number of complaints an investment adviser received from 2009 to 2011, which reflects the extent an adviser misbehaves prior to the treatment. Alternatively, we measure past misconduct using the log number of complaints $\log(1 + \#Complaints)$ and the number of complaints adjusted for characteristics of the RIA, $\epsilon_t^{Complaints}$. Table 14 reports the results.⁴⁰

[Table 14]

Regression (1) in Table 14 shows investment advisers that had a complaint during 2009 to 2011 (Pre-Treatment) were 9.4% more likely to have a complaint in 2012 to 2014 (Post-Treatment). The unconditional recidivism we observe is in line with that documented by Egan et al. (2017a). For investment advisers at RIAs that switched to state regulation from SEC oversight, the probability of recidivism during 2012 to 2014 increased 7.2% more, a 77% increase over the control group. In regression (2), we add RIA fixed effects and find very similar results, suggesting investment advisers that misbehaved more at a specific RIA also responded more to the treatment than other advisers at the same RIA. In regression (3), we limit the sample to only mid-size RIAs to compare treated mid-size RIAs with untreated mid-size RIAs located abroad, in Wyoming, and in New York. We find directionally similar results and the treatment response is stronger. Regressions (5) and (6) do tests using the log number of complaints in the past and future and show that representatives that misbehaved relatively more in the past that were also treated received relatively more complaints than similar advisers that were not treated. Regressions (7) to (9) show a similar result using complaint rates adjusted for RIA and state characteristics.

⁴⁰The benchmark is a number of Form ADV characteristics indicating conflicts of interest and AUM, plus state fixed effects. The residual comprises excess complaint variation not attributable to the RIA or state.

5.6 Misconduct Rates of Small-Size Advisers (<\$25M AUM)

The Dodd-Frank did not shift oversight of small-size RIAs (less than \$25M AUM), which remained under the oversight of state regulators. On the one hand, clients of small-size RIAs may complain more because state regulators are more concerned with local misconduct than a national regulator. This logic suggests that when the Dodd-Frank expands the oversight responsibility of state regulators to include mid-size RIAs, clients of small-size RIAs should complain less. On the other hand, if state regulators simply become more burdened, then misconduct by advisers may increase, resulting in more complaints. Table 15 regression (2) shows that small-size RIAs saw a significant increase in complaint rates of 0.35 percentage points. The effect is robust to specifications using individual and RIA fixed effects and matched samples, where the match was again done on the pre-trend years of 2009 and 2010 but not 2011.⁴¹ The magnitude of the increase in complaint rates by always-state-registered advisers appears to be smaller than that of treated mid-size advisers. The evidence overall supports the latter logic that state regulators became more burdened as a result of Dodd-Frank.

[Table 15]

5.7 Addressing Other Alternatives

We performed two other robustness checks relating to institutional details that could drive our interpretation. The first concern is a potential delay in when the complaint was received after the misconduct. That is, if complaints in 2012 redress prior misconduct, then the increased rise in complaints could reflect opportunistic complaints by customers of re-jurisdictioned mid-size advisers. Figure 4 is therefore helpful in dispelling this one potential alternative. The gap between treated and untreated appears to persist through 2014, mitigating the alternative that complaints merely reflect a backlog. Cross-sectional evidence also casts doubt on this

⁴¹We do not observe the ADV data for the never-SEC-registered RIAs, so we cannot do propensity score matching on which RIA characteristics affect the probability of being treated. Instead we do nearest-neighbor matching on historical complaint count and number of years as an adviser representative.

alternative.⁴²

A second alternative is that either the SEC has a more lax or a state regulator has a more stringent reporting standard for complaints. However, we believe this is not an issue for numerous reasons.⁴³ We provide a lengthy discussion in A.3.

A third concern is that the control group may be changing because the SEC becomes busier overseeing hedge funds and private equity firms. We therefore see a drop in complaints for SEC firms, not a rise at the state level. However, this would not explain the results exploiting cross-sectional variation among the re-jurisdictioned mid-size advisers. It would also be inconsistent with results on sub-midsize advisers. If only the SEC changed behavior, then the within-person, within-RIA change in complaint rates would not vary between the mid-size and small-size advisers.

A fourth concern is that some firms may re-register with the SEC. To check this does not influence our results, we define treatment as de-registering partially from the SEC with the requisite AUM, and *never registering* by the end of 2015. When we do this, the results remain similar.

6 Conclusion

We provide evidence that Dodd-Frank weakened oversight of mid-size RIAs, and more generally that national regulators better deter financial misconduct. Specifically, we find the re-jurisdiction of RIAs from SEC to state regulators due to the Dodd-Frank Act increased misconduct by 60% on average. The complaints are not obviously frivolous, but more severe in that

⁴²For this alternative, it would suggest that customers saw states have immediate capacity to handle complaints. However, we provide three pieces of cross-sectional evidence. First, the states with lower staff-per-RIA had higher complaints, whereas capacity would suggest the opposite. Second, firms closer to the regulator saw fewer complaints, whereas these firms would likely be the favored firms by the regulator. Third, the less sophisticated investors are the least likely to be aware of regulator capacity, yet were the likeliest to complain.

⁴³Several regulators we talked to confirm disclosure reporting is handled by FINRA, not by the relevant SEC or state regulator. This division of responsibility suggests that regulator involvement in expungement of records or the general reporting standards is likely not correlated with treatment. Also, to the extent regulator effort is required to intervene in the case of an expungement, for example, our forthcoming result suggests treatment is higher where regulators are less likely to be well-staffed. Moreover, we performed our analysis using data gathered in 2015 and 2016, achieving similar results. There is some delay between reporting a complaint and how long an adviser must wait to redact it. Finally, from inspecting the data by hand, often we actually observe cases that constitute cases that are no longer reportable, and have been asked by the adviser to be removed. In such cases, the complaint details (alleged damages and the case description, for example) are redacted, not the disclosure itself. Therefore, the extensive margin analysis is unlikely to be affected by these concerns.

they are likelier to result in an award. RIAs in states with fewer regulatory resources and those located farther from the respective state regulator saw the greatest increases in complaints. Investment advisers with histories of greater misconduct seem to have taken more advantage of the weaker regulator. More sophisticated investors, like institutions and governments, were less affected and perhaps more able to monitor their advisers. Meanwhile, clients with less education and who are older were more often the victims of misconduct. The evidence contrasts with the plausible alternative hypothesis that a local regulator has advantages deterring financial misbehavior stemming from soft information and a local focus. Perhaps, at least in the case of the oversight of investment advisers, the optimal allocation of resources for regulation is to reallocate state-level budgets to the SEC.

Our findings suggest state securities regulators may potentially be less of a deterrent than the federal regulator on average. The evidence that state financial oversight is weaker using data on investment advisers complements the findings of Agarwal et al. (2014), who study the effects of re-jurisdictions between state and national bank regulation. Our findings provide valuable external validity and further contribute by demonstrating that variation in state regulatory quality may depend on financial resources. The regulator's deterrence is constrained by their staffing and physical distance, which limits monitoring ability. Future research should further isolate the various mechanisms that do and do not matter for a financial regulator's oversight ability and enforcement, such as a regulator's reputation, institutional knowledge and practices, and its human capital.

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7 Figures and Tables

Figure 1: Event Timeline

July 21, 2011 to December 31, 2011	January 1, 2012	March 30, 2012	June 28, 2012
New registration thresholds and requirements apply to new applicants, but not to existing SEC-registered advisers until the dates indicated in this table, as applicable.	Each SEC-registered adviser as of July 21, 2011 must remain registered with the SEC until this date (unless relying on an exemption).	Last day for all SEC-registered advisers to file the required Form ADV amendment.	Mid-sized advisers not eligible for SEC registration must file form ADV-W to withdraw by this date.

Figure 2: Annual ADV De-registration Filings

Graph showing RIAs de-registered from the SEC in 2012 in response to the Dodd-Frank Act. To indicate a change in registration status (cessation, merger, or partial de-registration), RIAs file a Form ADV-W. In the graph, the line “ADV-W Filings” refers to the total number of filed Form ADV-Ws. “Partial de-registration” presents the number of Form ADV-Ws for a partial de-registration. An optional field in Form ADV-W allows RIAs to specify the reason for partial de-registration. The line (“# Mention state de-registration”) indicates how many partial de-registrations specifically mentioned the intention to register with state securities regulator.

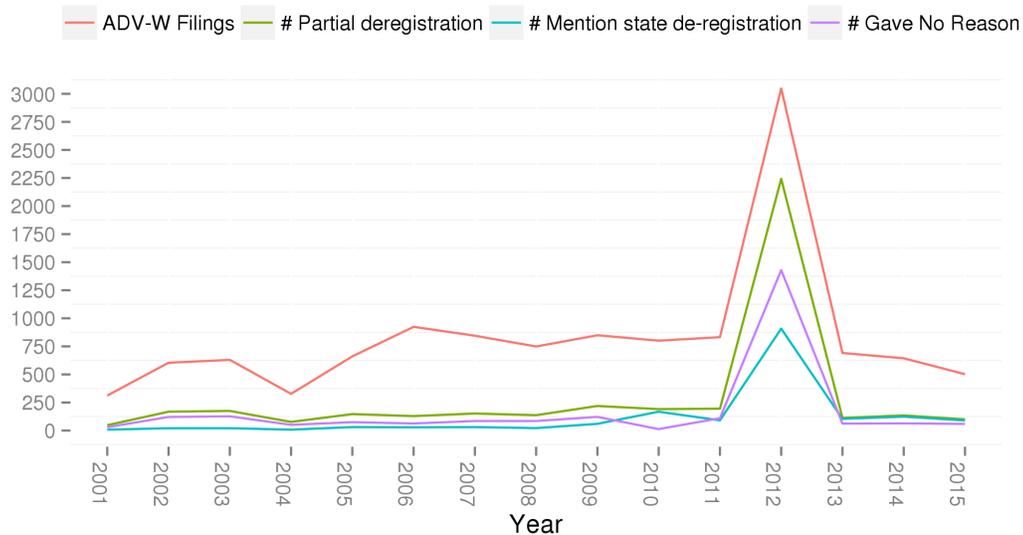


Figure 3: Filing a Customer Complaint

Figure illustrates how customers file a complaint with the New Jersey Securities Regulator.

NEW JERSEY DIVISION OF
CONSUMER AFFAIRS



Steve C. Lee
Acting Director



NEW JERSEY
BUREAU OF SECURITIES



File a Complaint

The Bureau of Securities investigates complaints against individuals and firms selling securities or offering investment advice as well as companies issuing securities investments. The Bureau is empowered to bring administrative actions or civil law suits to enforce the registration and anti-fraud provisions of the New Jersey Uniform Securities Act. The Bureau may refer certain matters for criminal prosecution.

Please be advised that the Bureau does not have the specific authority to order restitution or the repayment of any monies which you may believe are due you.

Investor Information

Name:

Street Address:

City: State: ZIP Code:

Daytime Number: Evening Number: Fax:

Email Address:

Firm Information

Firm Name:

Street Address:

City: State: ZIP Code:

Telephone Number (1): Telephone Number (2):

Email Address:

Complaint Information

1. Type of firm (if known):

If other, please specify:

2. Name and title of firm's agents or employees with whom you dealt:

Name:

Title:

Figure 4: Parallel Trends

Figure shows trends in complaint rates for advisers registered with the SEC from 2009 to 2014 (baseline) with those advisers who switched from SEC to state regulation in 2012 (treated). The baseline group is formed based on a matched sample, forcing similar complaint rates in 2009 and 2010 and requiring advisers be in the same state. No complaint matching is done on 2011 data. The trend from 2010 to 2011 is parallel consistent with parallel trends but then diverges on treatment in 2012, when Dodd-Frank shifts oversight of mid-size (\$25M-\$100M in AUM) advisers to state regulators.

Dependent variable: $Pr(Complaint_t)$

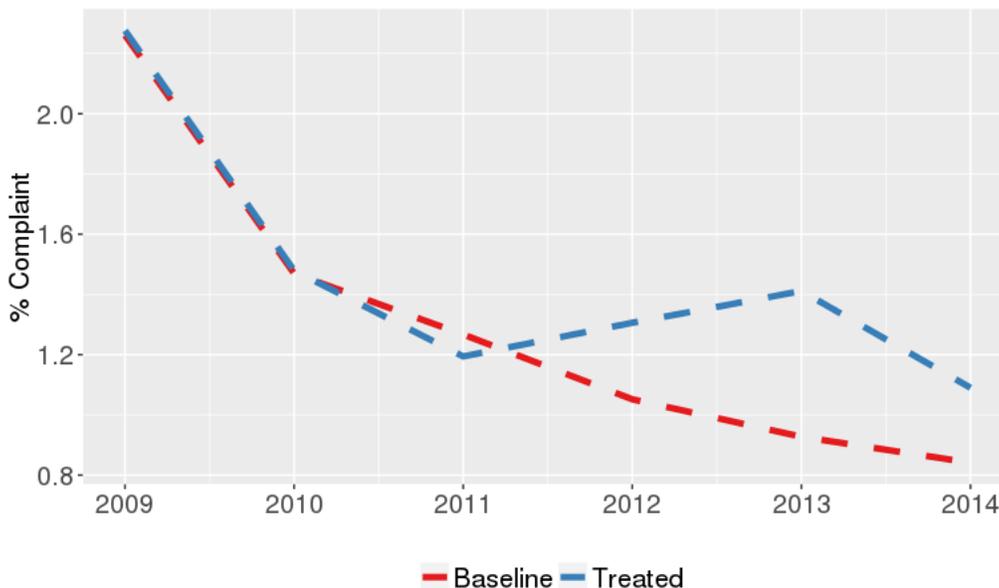


Figure 5: State Regulator Budgets

The figure below shows the proposed state regulator budgets, where the requested budget for calendar year 2009 is normalized to be 1 due to different state departmental organizations. The bolded line is the average across all states. Most states request budgets on a biannual basis.

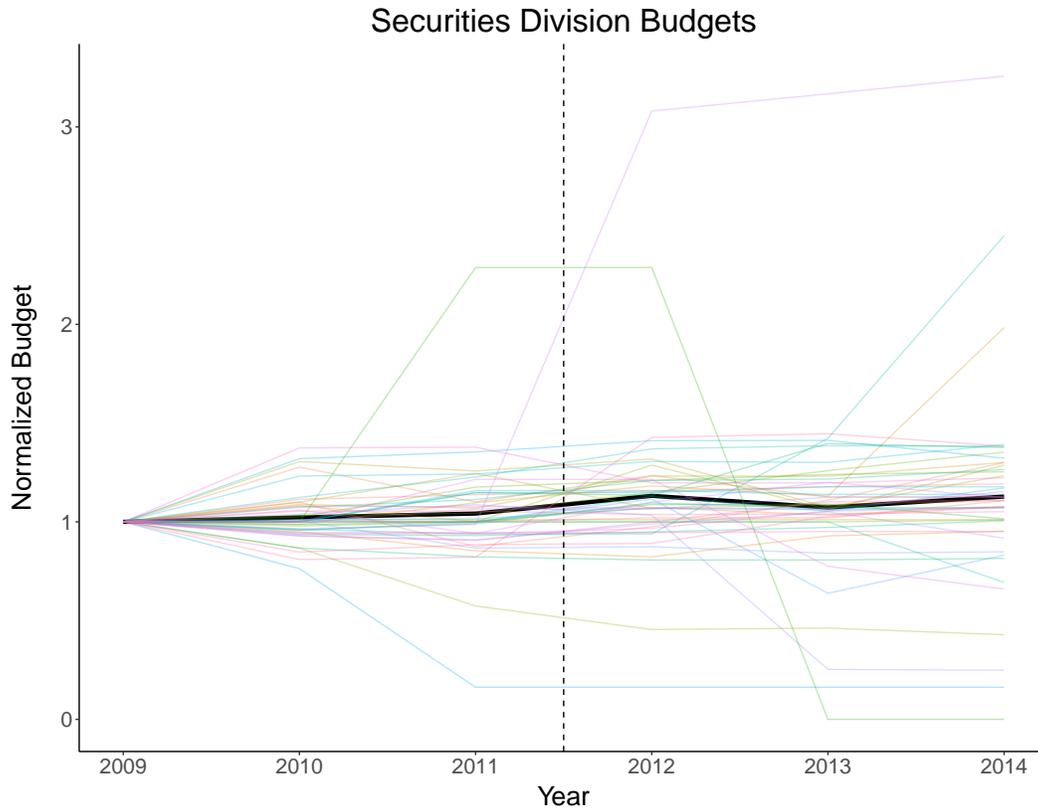


Table 1: Observation counts

The table below shows summary statistics of our data constructed by merging the universe of RIAs' Form ADV filings and the universe of individual adviser representative reports to create a survivorship bias free data set.

Sample	N
# Unique representative CRDs in IAPD	492,841
# Unique RIA CRDs in IAPD	30,579
# Unique CRDs in SEC Form ADV	6,235
# RIA-year observations in IAPD	4,623,292
# Obs (2009-2014)	1,791,522
# Obs (Annual Sample)	1,290,043
# Obs (Three-year-treatment window)	382,665
# RIAs treated	2,316
# Individuals treated	23,547
# Individual-year treated	129,171
# Always State-registered RIAs	17,821
# Always State-registered individuals	97,264

Table 2: RIA Summary Statistics

The table provides summary statistics for investment adviser RIAs. All summary statistics are reported for the Form ADV filing for 2011. RIAs check whether they have any custody over assets, independent audits, specific incentive structures, and their client compositions. They also report the fraction of assets they have custody of.

	Total	Untreated	Treated
N with non-missing AUM	6,226	3,910	2,316
Assets:			
AUM 10 th Percentile	35	103	30
AUM 25 th Percentile	57	143	39
AUM 50 th Percentile	128	295	53
AUM 75 th Percentile	422	882	72
AUM 90 th Percentile	1,841	4,090	89
Fraction of AUM with Custody (%)	7	6	14
Fraction of RIAs with Custody (%)	18	24	8
Fraction with Independent Audits (%)	21	29	9
Incentive Structure:			
Private Fund (%)	26	32	15
Other Business (%)	16	15	18
Other Business is Main Business (%)	5	5	6
Recommends a Broker (%)	64	68	58
Have Proprietary Conflicts of Interest (%)	87	88	86
Have Sales Conflicts of Interest (%)	20	27	10
Have Investment Discretion (%)	93	94	90
Client Composition:			
Individuals (%)	69	66	75
Unsophisticated Individuals (%)	35	29	45
Institutions (%)	43	47	36

Table 3: Summary Statistics around Dodd-Frank

Panel A: The table below shows summary statistics for complaints in the pre- and post-treatment periods. For each complaint case, we calculate the frequency of a case status as withdrawn, closed, denied, settled, or entering arbitration or litigation. Sample counts used in econometric analysis are larger than the counts displayed here as not every case status is populated.

Case Status Period:	Treated 2009-2011	Untreated 2009-2011	Treated 2012-2014	Untreated 2012-2014
Withdrawn	3%	2%	1.2%	2.4%
Closed - No Action	12.2%	6%	12.3%	6.1%
Denied	30.5%	47.1%	32.2%	46.6%
Settled	40%	37.6%	46.8%	15.1%
Arbitration or Litigation	12%	7.3%	7.6%	5.9%
\$ Alleged Damages	357,068	374,111	203,155	206,377
\$ Settlements (when non-zero)	187,076	208,380	195,640	202,314

Panel B: The below table breaks down complaints with details into those associated different products and complaint types. Complaint types are codified directly by the IAPD to classify complaints. The types of complaints and the related products are not mutually exclusive. Customers may file complaints of multiple types, associated with multiple products.

Product			Type		
	Number	% of Total		Number	% of Total
Annuity	7,122	28.32	Suitability	9,955	39.58
Variable Annuity	6,498	25.84	Misrepresentation	8,620	34.27
Mutual Fund	5,371	21.36	Fiduciary	1,943	7.73
Equity	5,040	20.04	Unauthorized Trading	1,827	7.26
Insurance	2,108	8.38	Fraud	1,484	5.90
Debt	2,051	8.16	Fees	1,306	5.19
Real Estate	1,941	7.72	Portfolio Allocation	669	2.66
OTC	1,105	4.39	Churning	567	2.25
Options	591	2.35			
Fixed Annuity	578	2.30			
Private Placements	409	1.63			

Table 4: Baseline Results

The table below shows the difference-in-differences estimates of the impact of switching from SEC to state registration on the propensity to receive a complaint. The sample is investment adviser representatives working at RIAs under SEC oversight (RIAs filing ADV to the SEC) in 2011. The first three columns present annual, person-year panels and the second three collapse three-year period around 2012 as suggested by Bertrand et al. (2004). In the latter, all individuals must work the entire three year period to be considered. The dependent variable is the percent receiving a complaint. Robust standard errors clustered by state are presented.

<i>Dependent variable:</i>		$1_{\{Complaint_t\}} * 100$				
	(1)	(2)	(3)	(4)	(5)	(6)
Sample	Annual sample			Pre-post Sample		
Constant	1.266*** (0.168)			3.693*** (0.479)		
Post ²⁰¹²	-0.802*** (0.088)			-2.310*** (0.243)		
Treated	-0.466*** (0.171)			-1.760*** (0.468)		
Post ²⁰¹² × Treated	0.529*** (0.161)	0.544*** (0.143)	0.574*** (0.164)	1.841*** (0.446)	1.764*** (0.431)	1.653*** (0.726)
Fixed Effects		RIA + Year	RIA + Year +Individual		RIA	RIA + Year +Individual
Observations	1,299,819	1,299,819	1,299,819	382,665	382,665	382,665
R ²	0.003	0.011	0.252	0.007	0.024	0.628

Note: *p<0.1; **p<0.05; ***p<0.01

Table 5: Robustness: Alternative Comparison Groups

The table below shows alternative specifications. Column 1 removes California, which is home to the highest number of investment advisers. Column 2 excludes New York and Wyoming because advisers in these two states stayed with the SEC. Column 3 removes any adviser with over \$100 million in AUM, forcing the control group to be other mid-size advisers in New York and Wyoming. Column 4 presents a placebo estimate defining the treatment year as 2005. Column 5 presents a matched sample exercise, where we find matches with replacement from the same state, with the same three-year complaint count, and the same pre-trend (whether they received complaints in 2009, 2010, 2011). Finally, they are propensity score matched in the post period as working for a RIA with the same probability of being treated. Column 6 is an alternative matched sample, relaxing the constraint that the individual comes from the same state. The unit of observation is at an individual level, in a three-year window around the implementation of state registration. Robust standard errors clustered by state are presented in the OLS samples. Standard errors for the matched samples are clustered at the level of match pair following the recommendation of Abadie and Spiess (2016).

<i>Dependent variable:</i>		$1_{\{Complaint_t\}} * 100$				
	(1)	(2)	(3)	(4)	(5)	(6)
Sample:	Exclude CA	Exclude NY/WY	≤ 100 MM	Placebo	Match 1	Match 2
Post ²⁰¹² × Treated	0.595** (0.177)	0.541*** (0.184)	1.337*** (0.212)	-0.083 (0.313)	0.711*** (0.068)	0.672*** (0.161)
Fixed Effects	RIA + Individual + Year	RIA + Individual+ Year	RIA + Individual + Year	RIA + Individual + Year	RIA + Individual+ Year	RIA + Individual+ Year
Observations	1,232,293	932,840	66,960	704,235	321,941	327,417
R ²	0.252	0.276	0.344	0.244	0.250	0.270

Note:

*p<0.1; **p<0.05; ***p<0.01

Table 6: Customer Complaint Decomposition

The table below decomposes the complaint types in the three-year-collapsed window around treatment in 2012. Dependent variables are scaled to be a probability multiplied by 100. All regressions include RIA and year fixed effects. Robust standard errors clustered by state are presented.

Panel A: Complaint Allegation Types									
Allegation Type:	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Churning	Adviser	Portfolio	Fees	Fiduciary	Fraud	Misrepresentation	Suitability	Unauthorized
Post ²⁰¹²	-0.025***	-1.037***	-0.029*	-0.108*	-0.144***	-0.068**	-0.792***	-0.855***	-0.101***
	(0.007)	(0.146)	(0.017)	(0.065)	(0.041)	(0.031)	(0.216)	(0.255)	(0.019)
Post ²⁰¹² ×Treated	0.073	0.600**	0.025	-0.047	0.360	0.363*	1.116***	1.089**	0.111**
	(0.076)	(0.264)	(0.028)	(0.101)	(0.257)	(0.205)	(0.383)	(0.420)	(0.050)
Observations	381,006	381,006	381,006	381,006	381,006	381,006	381,006	381,006	381,006
R ²	0.012	0.020	0.035	0.007	0.043	0.040	0.026	0.024	0.006
Adjusted R ²	-0.002	0.007	0.022	-0.007	0.034	0.027	0.012	0.010	-0.008
Panel B: Complaint Product Type									
Product Type:	(1)	(2)	(3)	(4)	(5)	(6)	(7)		
	OTC	Options	Insurance	Equity	Real Estate	Private Pl	Managed Act		
Post ²⁰¹²	-0.013	-0.018***	-0.169***	-0.333***	0.057**	-0.048*	0.011		
	(0.018)	(0.006)	(0.048)	(0.051)	(0.026)	(0.026)	(0.010)		
Post ²⁰¹² ×Treated	0.139	0.093**	-0.394*	0.409**	0.409**	0.063	0.007		
	(0.119)	(0.033)	(0.225)	(0.192)	(0.189)	(0.042)	(0.018)		
Observations	381,006	381,006	381,006	381,006	381,006	381,006	381,006		
R ²	0.018	0.006	0.015	0.014	0.034	0.029	0.011		
Adjusted R ²	0.004	-0.007	0.002	0.001	0.021	0.016	-0.003		

Note:

*p<0.1; **p<0.05; ***p<0.01

Table 7: Do Other Adviser Disclosures Increase?

Panel A in the table below shows the treatment effect for RIAs who were never registered with the SEC, those advisers that had $AUM < \$25M$. The specifications are either a matched sample on individual characteristics, an annual panel, or a pre-post collapsed sample a la Bertrand et al. (2004). Panel B in the table repeats the main specifications but looks at changes in disciplinary actions related to regulatory, financial, criminal, and termination issues. Dependent variables are scaled to be a probability and multiplied by 100. Robust standard errors clustered by state are presented.

	(1)	(2)	(3)	(4)
Dependent Variable:	$1_{\{Regulatory_t\}}$	$1_{\{Financial_t\}}$	$1_{\{Criminal_t\}}$	$1_{\{Termination_t\}}$
Post ²⁰¹² ×Treated	0.053 (0.052)	-0.133 (0.093)	0.012 (0.008)	-0.042 (0.032)
Observations	1,299,819	1,299,819	1,299,819	1,299,819
Fixed Effects	RIA + Year	RIA + Year	RIA + Year	RIA + Year
R ²	0.024	0.005	0.003	0.003
Note:	*p<0.1; **p<0.05; ***p<0.01			

Table 8: Alleged Damages Analysis

The table below shows results for alleged damages for client complaints. Alleged damages are in dollars. Observations are at the case level. Robust standard errors clustered by RIA headquarter state are shown in parentheses.

Dependent Variable:	log(1+Alleged Damages)			
	(1)	(2)	(3)	(4)
Post ²⁰¹² ×Treated	0.478 (0.368)	0.599 (0.373)	0.666 (0.420)	0.225 (0.438)
Fixed Effects	RIA+Year	Branch + Year	RIA + Branch+ +Year	RIA + StateYear
Observations	19,355	18,607	18,607	19,355
R ²	0.161	0.184	0.290	0.175
	*p<0.1; **p<0.05; ***p<0.01			

Table 9: Complaint Noise-to-Signal Ratio Measured by Case Award and Denial Rates

Panel A: This table reports the relation between treatment and the award amount. Observations are at the case level. Cases resulting in no remuneration are included (settlements are reported as 0, or are missing and the case is denied, withdrawn or there is no action taken which we code as 0 award). Cubic controls refer to 1st, 2nd and 3rd orders of $\log(\text{alleged damages})$ as controls. Pending cases and cases with zero alleged damages reported are removed. Robust standard errors clustered at the RIA-headquarter state level are reported.

<i>Dependent Variable:</i>	log(1+Award)		1{Award}	
	(1)	(2)	(3)	(4)
Post ²⁰¹² ×Treated	0.404 (0.401)	1.126*** (0.346)	0.043 (0.042)	0.111*** (0.034)
Fixed Effects	RIA Year	RIA State x Year	RIA Year	RIA State x Year
Cubic Controls?	Y	Y	Y	Y
Observations	15,057	15,057	15,057	15,057
R ²	0.337	0.350	0.242	0.256

*p<0.1; **p<0.05; ***p<0.01

Panel B: This table examines the relation between treatment and the probability that a case has a positive value of $1_{\{\text{Withdrawn/No Action/Denied}\}}$ signifying a case results in being withdrawn, denied or resulting in no action. These cases generally result in the client receiving no settlement. Pending cases are removed. Robust standard errors clustered by RIA headquarter state are shown in parentheses.

<i>Dependent Variable:</i>	$1_{\{\text{Withdrawn/No Action/Denied}\}}$		
	(1)	(2)	(3)
Post ²⁰¹² ×Treated	-0.040 (0.036)	-0.080*** (0.030)	-0.064 (0.059)
Fixed Effect	RIA + Year	RIA + StateYear	RIA+Branch+ StateYear
Polynomial Order Control?	Y	Y	Y
Observations	19,355	19,355	18,607
R ²	0.319	0.329	0.460

*p<0.1; **p<0.05; ***p<0.01

Table 10: Staffing of the Investment Adviser Regulatory Office

This table presents the difference-in-difference estimates with triple interactions on the staff-per-RIA devoted to adviser regulation in the year 1999. Staff-per-RIA is the number of oversight employees at the state regulator divided by the number of RIAs. The data are retrieved from the American Association for Retired Persons. The first two estimates assume states without a dedicated staff for regulating investment advisers in 1999 have zero staff, the last two specifications drop these states from the analysis. Robust standard errors clustered by state are shown in parentheses.

<i>Dependent variable:</i>	$1_{\{Complaint_t\}} \times 100$			
	(1)	(2)	(3)	(4)
Post ²⁰¹² × Treated × Staff-per-RIA	-0.477*** (0.143)	-0.4645*** (0.163)	-0.457*** (0.177)	-0.465*** (0.201)
Post ²⁰¹² × Treated	0.528*** (0.132)	0.562*** (0.144)	0.412*** (0.146)	0.448*** (0.165)
Post ²⁰¹² × Staff-per-RIA	0.00 (0.065)	0.017 (0.084)	0.017 (0.065)	0.030 (0.089)
Fixed Effects	RIA + Year	RIA + Individual + Year	RIA + Year	RIA + Individual + Year
Observations	1,297,781	1,297,781	1,144,536	1,144,536
R ²	0.011	0.251	0.011	0.258

*p<0.1; **p<0.05; ***p<0.01

Table 11: Distance to Regulator and Complaint Rates

This table presents difference-in-difference estimates using the annual panel data. Local offices addresses are as of 2015 from the websites of NASAA, FINRA and the SEC. Distances in miles are calculated using coordinates of the zip code of the firm or regulator's address. Robust standard errors clustered by state are shown in parentheses.

<i>Dependent variable:</i>	$1_{\{Complaint_t\}} \times 100$						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Post ²⁰¹² ×Treated	0.530*** (0.140)	0.385*** (0.145)	0.391*** (0.139)	0.389*** (0.145)	0.080 (0.195)	0.146 (0.182)	0.143 (0.177)
Post ²⁰¹² ×Treated×log(<i>Dist_{State}</i>)	0.220* (0.128)	0.232** (0.100)	0.237** (0.105)	0.217** (0.111)	0.337** (0.138)	0.279* (0.143)	0.281** (0.1437)
Post ²⁰¹² ×Treated×log(<i>Dist_{SEC}</i>)			0.164* (0.100)				-0.042 (0.120)
Post ²⁰¹² ×Treated×log(<i>Dist_{FINRA}</i>)				0.001 (0.1090)	0.235 (0.240)	0.246 (0.244)	
Post ²⁰¹² ×log(<i>Dist_{State}</i>)	0.001 (0.064)	0.010 (0.145)	0.006 (0.061)				0.245 (0.243)
Post ²⁰¹² ×log(<i>Dist_{SEC}</i>)			0.055 (0.077)				0.028 (0.070)
Post ²⁰¹² ×log(<i>Dist_{FINRA}</i>)				0.001 (0.109)			
Fixed Effects	RIA Year	RIA <i>State</i> × <i>Year</i>	RIA <i>State</i> × <i>Year</i>	RIA <i>State</i> × <i>Year</i>	RIA <i>HQZip</i> × <i>Post</i> Individual	RIA <i>HQZip</i> × <i>Post</i> Individual <i>Branch</i> × <i>Post</i> <i>State</i> × <i>Year</i>	RIA <i>HQZip</i> × <i>Year</i> Individual <i>Branch</i> × <i>Year</i>
Observations	1,289,730	1,289,730	1,289,730	1,289,730	1,289,730	1,289,730	1,289,730
R ²	0.011	0.012	0.011	0.024	0.251	0.267	0.268

*p<0.1; **p<0.05; ***p<0.01

Table 12: The Treatment Effect and Branch-level Demographics

This table presents the results interacting re-jurisdiction with client demographics in the county in which the adviser representative works. The variable of interest is the triple interaction between treatment in the post period and a relevant demographic characteristic. Column 1 presents data from the 2011-2015 ACS, and columns 3 and 4 use data from the 2012 one-year ACS. % College is defined as the fraction of the county's adult population from age 24-54 with at least a Bachelor's education, and % Age > 60 is the fraction of the population aged 60 or above. Robust standard errors clustered by state are shown in parentheses.

<i>Dependent variable:</i>	$1_{\{Complaint_t\}} \times 100$			
	(1)	(2)	(3)	(4)
County Type:	% College	% College	% College	%Age > 60
Post ²⁰¹² ×Treated	0.578** (0.166)	0.567*** (0.166)	0.560*** (0.185)	0.563*** (0.182)
Post ²⁰¹² ×County Type	0.194*** (0.183)	0.212*** (0.443)	0.0721 (0.117)	-0.057** (0.028)
Post ²⁰¹² ×Treated×County Type	-0.187** (0.093)	-0.194** (0.093)	-0.232** (0.0103)	0.345*** (0.092)
Fixed Effects	RIA + Year	RIA + Year Branch	RIA + Year Branch	RIA + Year Branch
Observations	1,232,838	1,232,838	1,179,899	1,180,101
R ²	0.011	0.022	0.020	0.020

*p<0.1; **p<0.05; ***p<0.01

Table 13: Client Composition at the Firm-Level and Client Complaint Rates

This table presents the difference-in-difference estimates sorted by client composition of the RIAs as reported on the firms' 2011 ADV. Indicator variables equal 1 if the firm takes money as a private fund, or from clients who are accredited investors, institutional investors or government agencies. The sample includes only those that report taking money from one of these groups, or unaccredited individuals - those with missing information are excluded. Robust standard errors clustered by RIA headquarter state are shown in parentheses.

<i>Dependent variable:</i>	$1_{\{Complaint_t\}} \times 100$				
	(1)	(2)	(3)	(4)	(5)
Post ²⁰¹² × Treated	0.377** (0.178)	0.532*** (0.155)	0.541*** (0.175)	0.524*** (0.178)	0.400** (0.202)
Post ²⁰¹² × Treated × 1{AdvisesPrivateFunds}	0.102 (0.387)				0.097 (0.388)
Post ²⁰¹² × Treated × 1{Government}		-0.982** (0.476)			-0.868* (0.050)
Post ²⁰¹² × Treated × 1{Institutions}			-0.250 (0.238)		-0.936* (0.479)
Post ²⁰¹² × Treated × 1{AccreditedInvestors}				-0.121 (0.264)	0.829 (0.590)
Fixed Effects	RIA + Year	RIA + Year	RIA + Year	RIA + Year	RIA + Year
Observations	1,241,722	1,241,722	1,241,722	1,241,722	1,241,722
R ²	0.011	0.011	0.011	0.011	0.011

*p<0.1; **p<0.05; ***p<0.01

Table 14: The Effect of Regulatory Jurisdiction on Recidivism

This table presents a cross-sectional test of complaints received in the 2012-2014 period. The variable of interest is $Past \times Treated$, which is the interaction term between a variable describing the individual's past complaint history. Also of interest is the unconditional recidivism term, $Past$, which measures probability an adviser receives a complaint in the 2012-2014 period conditional on the value of $Past$ in 2009-2011. The measures of past activity include whether the individual has received a complaint before $1_{\{Past\ Complaints \geq 0\}}$, the log number of complaints $\log(1 + \#Past\ Complaints)$, and the residual number of complaints ϵ^{Past} . The latter is the residual of a regression based on a benchmark based on the characteristics of RIAs in which the individual worked in the past. Robust standard errors clustered by state are shown in parentheses.

<i>Dependent variable:</i>	$1_{\{Complaint_t\}} \times 100$								
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Past Measure =	$1_{\{Past\ Complaints \geq 0\}}$				$\log(1 + \# Past\ Complaints)$		ϵ^{Past}		
Constant	2.409*** (0.037)		1.402*** (0.232)				1.380*** (0.053)		
Past	9.346*** (0.367)	8.658*** (0.369)	4.800** (2.137)	4.752** (2.370)	12.139*** (0.533)	6.658* (3.413)	30.206*** (1.095)	27.841*** (1.181)	15.885** (7.567)
Treated	-0.023 (0.187)		1.032*** (0.298)				-0.269 (0.253)		
Past×Treated	7.145*** (2.514)	4.820* (2.513)	11.390*** (3.277)	8.465** (3.637)	7.114** (3.626)	12.139** (5.243)	19.907*** (6.944)	15.581* (7.963)	27.003** (11.622)
Fixed Effects		RIA		RIA	RIA	RIA		RIA	RIA
Sample	Full	Full	≤100 MM	≤100 MM	Full	≤100 MM	Full	Full	≤100 MM
Observations	183,423	183,423	9,723	9,723	183,423	9,723	183,423	183,423	9,723
R ²	0.014	0.038	0.028	0.185	0.040	0.186	0.016	0.038	0.185

*p<0.1; **p<0.05; ***p<0.01

Table 15: Treatment Effect on Existing State-Registered RIAs

The table below shows the treatment effect on RIAs always state registered (and never registered with the SEC), those with $AUM < \$25M$. The analysis excludes treated firms, comparing the *NeverSECRegistered* firms to the firms remaining with the SEC. As indicated in the table, we present the results of a two-period sample, annual sample, and a matched annual and two-period sample. Dependent variables are scaled to be a probability multiplied by 100. Robust standard errors clustered by state are shown in parentheses, except in the matched sample where it is clustered at the level of a matched pair as recommended by Abadie and Spiess (2016).

<i>Dependent variable:</i>	$1_{\{Complaint_t\}} \times 100$					
	(1)	(2)	(3)	(4)	(5)	(6)
Post ²⁰¹² × NeverSECRegistered	0.512*** (0.093)	0.345*** (0.110)	0.837*** (0.252)	0.694* (0.393)	0.247*** (0.073)	0.272* (0.236)
Fixed Effects	RIA + Year	RIA + Individual+ Year	RIA + Year	RIA + Individual + Year	RIA +Individual Year	RIA + Individual + Year
Observations	1,732,674	1,732,674	662,426	662,426	1,294,611	403,924
R ²	0.018	0.283	.036	0.631	.048	.651

*p<0.1; **p<0.05; ***p<0.01

A Appendix

A.1 Additional Institutional Details

Figure A.2: Assets under management growth

This graph presents the growth in assets under management of RIAs filing Form ADV to the SEC through 2014. We retrieved the ADV data from the SEC through a Freedom of Information Act request in 2015. For each RIA, we use the latest filing in the calendar year.

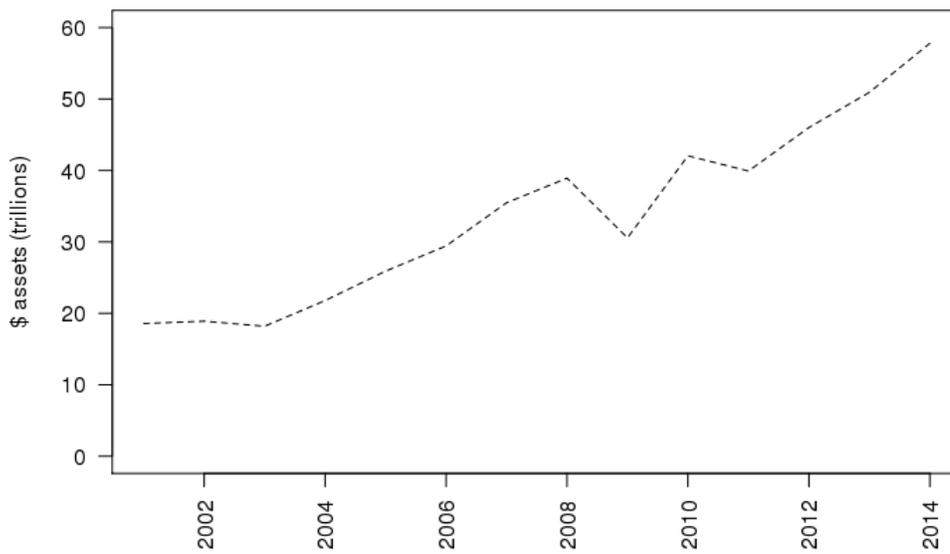


Table A.1: Form ADV Information

This table summarizes the components of Form ADV

Item in form ADV	Description
Item 1. Identifying Information	Address, business name, etc. normal business hours.
Item2. SEC Registration/Reporting	States of operation
Item3. Form of Organization	Are you a corporation, LLC? Where are you organized? What country's laws are you subject to?
Item4. Successions	Are you succeeding another business, e.g. inheriting clients?
Item5. Information about your Advisory Business	Regulatory AUM, lines of business, types of clients, compensation arrangements, types of services offered, num. employees, num. clients,
Item 6. Other Business Activities	Non-principal activities your firm engages in
Item 7. Financial Industry Affiliations	Are your related persons part of another financial institution, broker, law firm or accounting firm?
Item 7B Private Fund Reporting	Are you a private fund?
Item 8 Participation or Interest in Client Transactions	Do you have a proprietary interest in client transactions (do you trade your own funds)), a sales interest in client transactions (do you sell your clients stuff), or investment/brokerage discretion? And a lot of related detailed questions.
Item 9 Custody	Do you have custody of assets, of how much? Do your related persons have control? Do you have a qualified custodian, an independent accountant, that overlooks? Do you get surprise audits?
Item 10 Control Persons	Who are the control persons and how much do they own?
Item 11 Disclosures	Criminal, regulatory, civil lawsuits for the firm. Note: Not individual IAR history/roster.
Item 12 Small Business Schedule A/B/D	Various probably irrelevant things about control structure and total firm assets Direct/indirect owners, officers, with ownership stakes. Location of books and records. Other offices.

Table A.2: Investment Adviser Representative Exits

The table below shows the probability that an investment adviser representative drops out of our sample after receiving a complaint. The dependent variable Penultimate_t takes the value 1 if year t is the penultimate year an IAR exists in our sample. The dependent variable Ultimate_t takes the value 1 if year t is the last year an IAR exists in our sample, limiting it to end in 2014. Receiving a complaint is related to dropping out of our sample.

<i>Dependent variable:</i>	Penultimate _t					Ultimate _t				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Treated	2.258*** (0.250)	2.258*** (0.250)				4.637*** (0.247)	4.634*** (0.249)			
$1_{\{Complaint_t \geq 0\}}$	0.485** (0.193)					0.024 (0.037)				
$1_{\{Complaint_t \geq 0\}} \times Treated$	-0.282 (0.931)					1.757 (1.186)				
$\log(1 + \#Complaints_t)$		1.208*** (0.302)	1.235*** (0.324)	1.193*** (0.296)	1.024*** (0.266)		0.022 (0.047)	0.031 (0.045)	0.022 (0.047)	-0.017 (0.054)
$\log(1 + \#Complaints_t) \times Treated$		-0.515 (1.448)	-0.642 (1.467)	-0.544 (1.449)	-0.494 (1.513)		2.718 (1.674)	2.721 (1.662)	2.670 (1.673)	2.368 (1.551)
Observations	981,548	981,548	981,548	981,548	981,548	729,258	729,258	729,258	729,258	729,258
Fixed Effects		RIA					RIA			
R ²	0.028	0.028	0.028	0.030	0.074	0.033	0.033	0.032	0.034	0.079

Note: *p<0.1; **p<0.05; ***p<0.01

Table A.3: Different AUM Cutoffs

This table presents the main result using different AUM cutoffs. RIAs with 2011 AUM above the stated amount are excluded, such that the control group is all untreated RIAs below the indicated AUM level. Robust standard errors are clustered at the state level.

<i>Dependent variable:</i>	$1_{\{Complaint_t\}} \times 100$							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
AUM Cutoff =	100MM	150MM	200MM	250MM	300MM	350MM	400MM	450MM
Past×Treated	1.337*** (0.217)	0.823*** (0.294)	0.698** (0.272)	0.640*** (0.236)	0.491** (0.247)	0.479** (0.218)	0.469** (0.214)	0.444** (0.210)
Fixed Effects	RIA+Year+ Individual	RIA+Year+ Individual	RIA+Year+ Individual	RIA+Year+ Individual	RIA+Year+ Individual	RIA+Year+ Individual	RIA+Year+ Individual	RIA+Year+ Individual
Observations	66,960	87,047	102,216	113,765	126,390	143,501	153,038	159,435
R ²	0.344	0.353	0.353	0.351	0.349	0.341	0.342	0.341

*p<0.1; **p<0.05; ***p<0.01

A.2 State Securities Regulators

Table A.4: State Securities Regulators

The table below shows the names of state securities regulators, broken up into divisions and departments. Divisions are the smallest organizational entities that oversee securities regulation. For most states, the securities division is a sub-organization of a larger department such as the Secretary of State or the Attorney General's office. The value is blank when a departmental hierarchy is not provided.

State	Division Name	Department Name
Alabama	Alabama Securities Commission	
Alaska	Banking and Securities Division	Department of Commerce, Community, and Economic Development
Arizona	Securities Division	Arizona Corporation Commission
Arkansas	Arkansas Securities Department	
California	Securities Regulation Division	Department of Business Oversight
Colorado	Division of Securities	Department of Regulatory Agencies
Connecticut	Securities and Business Investment Division	Department of Banking
Delaware	Investor Protection Unit	Attorney General
Florida	Division of Securities	Office of Financial Regulation
Georgia	Division of Securities	Secretary of State Office
Hawaii	Division of Securities	Department of Commerce and Consumer Affairs
Idaho	Securities Section	Department of Finance
Illinois	Securities Department	Secretary of State
Indiana	Securities Division	Secretary of State
Iowa	Securities Bureau	Insurance Division
Kansas	Office of the Securities Commissioner	
Kentucky	Securities Division	Department of Financial Institutions
Louisiana	Securities Division	Office of Financial Institutions
Maine	Office of Securities	Department of Professional and Financial Regulation
Maryland	Securities Division	Attorney General
Massachusetts	Securities Division	Secretary of Commonwealth
Michigan	Corporations, Securities, and Commercial Licensing Bureau	Department of Licensing and Regulatory Affairs
Minnesota	Securities, Franchises, and Subdivided Land	Department of Commerce
Mississippi	Securities Division	Secretary of State
Missouri	Securities Division	Secretary of State
Montana	Commissioner of Securities and Insurance	Office of the Montana State Auditor
Nebraska	Department of Banking and Finance	
Nevada	Nevada Securities Center	Secretary of State
New Hampshire	Bureau of Securities Regulation	Secretary of State
New Jersey	Bureau of Securities	Division of Consumer Affairs
New Mexico	Securities Division	Regulation and Licensing Department
New York	Investor Protection Bureau	Attorney General
North Carolina	The Securities Division	Secretary of State

Table A.5: State Securities Regulators (continued)

State	Division Name	Department Name
North Dakota	Securities Department	
Ohio	Division of Securities	Department of Commerce
Oklahoma	Department of Securities	
Oregon	Division of Financial Regulation	
Pennsylvania	Department of Banking and Securities	
Rhode Island	Department of Business Regulations	
South Carolina	Securities Division	Attorney General
South Dakota	Division of Securities	Division of Licensing and Regulation
Tennessee	Department of Commerce & Insurance	Department of Commerce & Insurance
Texas	State Securities Board	
Utah	Division of Securities	
Vermont	Securities Division	Department of Financial Regulation
Virginia	Division of Securities and Retail Franchising	State Corporation Commission
Washington	Division of Securities	Department of Financial Institutions
West Virginia	Securities Commission	State Auditor's Office
Wisconsin	Division of Securities	Department of Financial Institutions
Wyoming	Investing Center	Secretary of State

A.3 Redacting Customer Complaints

One potential concern regarding our results is that redactions increased for RIAs that were treated relative to those that were not treated. First, state regulators may be more susceptible to regulatory capture, seeking to preserve the presence of investment advisers who may otherwise leave the state. Second, the inability of adviser representatives to redact their complaints drives our results, being in a state with more regulatory staff means more resources to process the complaints. Moreover, being farther from the corresponding state regulator would also mean redacting a complaint is more costly. We argue these alternatives are not likely in light of the legal environment through which redactions are processed.

Records are stored at FINRA through the CRD system. Complaints that have alleged damages over \$5,000 or resulted in some legal action are both reported in the system. Upon receiving a complaint, both the investment adviser RIAs and investment adviser representative have to file a complaint disclosure to the CRD system. In August 2010, FINRA began disclosing all historic complaints, regardless of age. In the past, unproven allegations were not disclosed after two years. Specifically, investment adviser representatives may want to remove over which

advisers have little control:

1. **Denied customer complaints.** Although denied customer complaints may seem insignificant, accusations typically are accompanied by harsh words that remain on the CRD for at least two years (since 2009, accusations stay for 10 years). Even if an adviser's record shows patterns of denied rather than arbitrated or settled complaints, RIAs also may be hesitant to affiliate with that adviser. Moreover, whether or not complaints are settled in the first place is mainly up to the RIA, not the representative.
2. **Termination explanations.** Broker-dealers may terminate advisers for any reason. Discrepancies can exist between the self-reported termination explanation and the RIA-reported explanation.

Investment advisers occasionally request expungement of customer complaints. Because the records are stored in the CRD, FINRA handles all expungement requests. Nonetheless, other regulators are involved in the process. FINRA may agree to remove disclosures if brokers obtain a recommendation that is false, erroneous, or that the broker wasn't involved in the alleged misdeed. To obtain this recommendation, representatives must acquire a court confirmation after submitting an expungement request. Upon submission, the corresponding investment adviser regulator (SEC or state regulator) is informed, giving a chance to oppose the expungement. State regulators received a total of 519 requests in 2010, up from 110 in 2009. In total, the process to expunge a complaint typically takes at least one year. Although FINRA claims to have tracked the number of expungements granted, they do not publicly disclose it.

Although the expungement process is fairly difficult, FINRA arbitrations could be settled subject to an agreement that claimants would not oppose the investment adviser representative's subsequent efforts to seek expungement from a court of competent jurisdiction. Subsequently, representatives would initiate unopposed petitions for expungement in state courts that were often rubber-stamped. The judge's order would then be submitted to FINRA, and the arbitration disclosure would be expunged. In response to this practice, FINRA adopted Rule 2130 in 2004. One of the most significant changes was the need to name FINRA as an additional party challenging expungement. This meant FINRA also receives all appropriate

documents with expungement, unambiguously increasing the cost of expungement requests. Moreover, although expungement requests from arbitrated cases are mostly granted, less than 8% of disclosures are expunged. Of the 7,621 arbitration cases from 2012 to 2014, only 563 records were expunged, according to the arbitration bar association.

Some of the surge in requests is also the result of new disclosure demands by FINRA. Until 2009, only brokers who were named as a party to a case had to disclose a customer complaint. Because most investors sue only the brokerage firm, large brokerage firms could shield individual brokers from direct accusations. However, firms might not have this incentive. Larger firms may also be more likely to place blame on an individual whom they could terminate, in order to shift blame to the individual. After 2009, FINRA modified this disclosure practice, requiring all brokers to report complaints regardless of whether they were named directly as a respondent.

The institutional setting suggests deletions of customer complaints is not relevant for the timing of the Dodd-Frank Act. Our phone calls with three regulators: California, Maryland, the SEC also suggest expungement is not an issue. Moreover, the censoring bias from any deleted complaints should not be correlated with treatment either. Finally, our specifications with state-year fixed effects and firm fixed effects absorb a lot of the drivers of expungement.