How Does the Economy Shape the Financial Advisory Profession?

September 4, 2019

Abstract

We examine whether economic conditions have a long-term impact on the composition of available financial advisors in the profession. We find that financial advisors who start their career in recessions are less likely to commit professional misconduct throughout their career, even compared with their colleagues working in the same firm, at the same location, and at the same point in time. We show that this relation between early economic conditions and advisor misconduct remains after controlling for differences in hiring firms, advisor job functions and quality, and opportunities to commit misconduct. Collectively, the evidence suggests a behavioral difference between recession and non-recession advisors and demonstrates that economic conditions impose a significant constraint on the types of financial advisors who are ultimately available in the profession.

Keywords: Financial advisor, recession, FINRA disclosure, misconduct, selection, imprinting.
JEL Classifications: D14, D18, G20, G24, G28, K22.

Kelvin K. F. Law
Assistant Professor
Nanyang Business School
Nanyang Technological University
Singapore
klaw@ntu.edu.sg

Luo Zuo
Associate Professor
SC Johnson College of Business
Cornell University
United States
luozuo@cornell.edu

We appreciate helpful comments from Audrey Wen-Hsin Hsu, Kun Li, Lillian Mills, Marcel Preuss, Kunyuan Qiao, Johan Sulaeman, Sheridan Titman, Laurence van Lent, and seminar participants at the Australian National University and the 2018 Taiwan Accounting Association Annual Conference and Asian Accounting Associations Conference. We thank Joey Han for excellent research assistance. Law acknowledges financial support from NTU's Start-Up Grant. Zuo acknowledges financial support from the Clifford H. Whitcomb Faculty Fellowship.

How Does the Economy Shape the Financial Advisory Profession?

Abstract

We examine whether economic conditions have a long-term impact on the composition of available financial advisors in the profession. We find that financial advisors who start their career in recessions are less likely to commit professional misconduct throughout their career, even compared with their colleagues working in the same firm, at the same location, and at the same point in time. We show that this relation between early economic conditions and advisor misconduct remains after controlling for differences in hiring firms, advisor job functions and quality, and opportunities to commit misconduct. Collectively, the evidence suggests a behavioral difference between recession and non-recession advisors and demonstrates that economic conditions impose a significant constraint on the types of financial advisors who are ultimately available in the profession.

Keywords: Financial advisor, recession, FINRA disclosure, misconduct, selection, imprinting.
JEL Classifications: D14, D18, G20, G24, G28, K22.

"In good times people are relaxed, trusting, and money is plentiful. … In depression all this is reversed. Money is watched with a narrow, suspicious eye. The man who handles it is assumed to be dishonest until he proves himself otherwise. Audits are penetrating and meticulous. Commercial morality is enormously improved." – Galbraith (1954, p. 133)

1. Introduction

Financial advisors help individuals manage their finances by providing investment, tax, and insurance advice, and executing transactions. In the United States, an aging population and rising life expectancy lead to a rapidly increasing demand for financial planning services. The U.S. Bureau of Labor Statistics (BLS) projected that the employment of financial advisors, which already accounted for 10 percent of total employment in the finance and insurance sector, would grow 15 percent from 2016 to 2026—much faster than the average for all occupations (BLS 2018). Given the prevalence and importance of financial advisors, a growing literature has developed to further an understanding of their behavior (O'Hara 2016). For example, Mullainathan, Noeth, and Schoar (2012) document that financial advisors often reinforce their clients' behavioral biases and misconceptions to further their own economic interests (e.g., maximizing fees). Egan, Matvos, and Seru (2019) document the coexistence of advisors with clean records and advisors who persistently commit misconduct. Related studies show that financial advisor misconduct is associated with pre-advisor criminal records (Law and Mills 2019), co-worker misbehavior (Dimmock, Gerken, and Graham 2018), and city-level norms (Parsons, Sulaeman, and Titman 2018). In this paper, we examine whether economic conditions have a long-term impact on the composition of available financial advisors in the profession.

We conjecture that financial advisors who start their career in recessions (we label them as "recession advisors") behave differently from those who start during other times for two mutually non-exclusive reasons. First, different types of people get selected (ex ante or ex post) into the financial advisory industry depending on the initial economic conditions (i.e., selection). The type of

candidates available for the financial advisory profession could differ over business cycles, and advisory firms could also change how they select or retain employees over time depending on the prevailing economic conditions. Second, a financial advisor's experiences at the early career stage shape her "intuitions and gut feelings" (Soltes 2016),[1] and, as a result, affect her conduct in the long-run (i.e., imprinting). Our conjecture is that, because of selection and imprinting, economic conditions impose a significant constraint on the types of financial advisors who are ultimately available in the profession.

While selection is based on common intuition, imprinting deserves more explanation. Imprinting is formally defined as "a process whereby, during a brief period of susceptibility, a focal entity develops characteristics that reflect prominent features of the environment, and these characteristics continue to persist despite significant environmental changes in subsequent periods" (Marquis and Tilcsik 2013, p. 199). At labor market entry, individuals usually experience anxiety and cognitive unfreezing, and are particularly open to environmental stimuli (Schein 1971). Thus, the start of an individual's career constitutes a critical and sensitive period of imprinting.[2] It is well-known that recessions are characterized by uncertainty, caution, and fear, and people are particularly vigilant of others' misconduct or illegal activities during those periods (Galbraith 1954; Kindleberger and Aliber 2005; Shiller 2005; Povel, Singh, and Winton 2007; Akerlof and Shiller 2009). Hence, financial advisors who enter the profession during recessions are exposed to an environment with tighter oversight and monitoring, and are likely to perceive a higher chance of being caught for any conceived misconduct. These advisors also have fewer opportunities to learn fraud techniques from

[1] In his book titled "*Why They Do It: Inside the Mind of the White-Collar Criminal*," Soltes (2016) shows that most of the white-collar criminals made decisions based on their intuitions and gut feelings.

[2] The long-term impact of early-career experiences has been documented for a variety of populations, including economists (Oyer 2006), investment bankers (Oyer 2008), corporate managers (Schoar and Zuo 2016, 2017), audit partners (He, Kothari, Xiao, and Zuo 2018), sell-side analysts (Clement and Law 2018), and loan officers (Campbell, Loumioti, and Wittenberg-Moerman 2019).

their colleagues and develop this type of task-specific human capital at career start (Gibbons and Waldman 2004, 2006). Further, by more frequently witnessing the negative consequences of misconduct to both perpetrators and their victims during economic downturns, recession advisors are more likely to form a belief that professional misconduct is socially unacceptable. Therefore, if recession advisors carry the imprint of their initial environment, they would be less likely to commit misconduct throughout their career.

Besides imprinting, economic conditions can also affect the financial advisor market through selection. During recessions, financial advisory firms might exert more effort screening job applicants when hiring junior staff. Given the heightened likelihood of being accused of misconduct, people with more aggressive risk appetite might also find it less attractive to join the financial advisory industry in bad economic times. Moreover, risk-averse, talented individuals might be more likely to survive a recession and stay in this profession. Together, these selection effects suggest that financial advisors who start their career during recessions are likely to be intrinsically different from their non-recession peers. The selection and imprinting effects coexist and are intertwined. Our first goal in this paper is to establish the link between early economic conditions and advisor misconduct. We then conduct analyses to ensure that this relation between early economic conditions and advisor misconduct is not entirely driven by differences in hiring firms, advisor job functions and quality, or opportunities to commit misconduct.

We construct a dataset of all financial advisors (around 1.3 million) who were registered with the U.S. Financial Industry Regulatory Authority (FINRA) at any point in time between January 2007 and July 2017.[3] This dataset is based on FINRA disclosure and contains an advisor's employment history, examinations completed, criminal records, customer complaints, and

[3] This dataset was retrieved in July 2017. Under FINRA Rule 8312, the SEC makes publicly available on the BrokerCheck website the records of all financial advisors registered within a 10-year window.

arbitration and settlement records. Using this dataset, we identify financial advisors who start during recessions and compare them with their peers who start during other times, where recessions are based on the business cycle dating database of the National Bureau of Economic Research (NBER).[4] Our sample consists of an unbalanced advisor-by-year panel that only includes the active years of an advisor over the period from 2007 to 2017. For example, for an advisor who joined the profession in 2000 and exited in 2010, this panel includes four annual observations (over 2007 to 2010) for this advisor. We conservatively define misconduct based on six FINRA disclosure categories that cover regulatory or criminal offenses, internal investigations, and customer disputes that were resolved against the advisor (Egan et al. 2019). The dependent variable *Misconduct* measures the flow of new misconduct over a one-year period and is a dummy variable indicating that the advisor had one or more misconduct records in that year (Egan et al. 2019).[5]

To test whether economic conditions at a financial advisor's career start predict her future misconduct over the career, we control for firm by county by year fixed effects in the regression specification so the comparison is between recession advisors and their colleagues from the same firm, at the same location, and at the same point in time. This set of high-dimensional fixed effects absorbs a host of factors that can affect advisor misconduct, such as variations in firms' tolerance for misconduct, different business models (e.g., retail versus non-retail) or incentive structures that firms may have, heterogeneity in state- or county-level regulatory or enforcement conditions, any

[4] Same as other studies on financial advisors (Dimmock, Gerken, and Graham 2018; Egan, Matvos, and Seru 2018, 2019; Parsons, Sulaeman, and Titman 2018), our approach centers on people who did become financial advisors and focuses on the intensive margin (i.e., how individual characteristics and behavior vary with economic conditions at career start). The benefit of this approach is that we can access a comprehensive set of financial advisors. The disadvantage is that we do not observe the extensive margin (i.e., people who never become financial advisors). However, as long as there is meaningful variation within the intensive margin, which is the case for financial advisors (Egan, Matvos, and Seru 2019), we are able to analyze the long-term effects of early economic conditions.

[5] The year the misconduct was recorded on BrokerCheck is not necessarily the year when the misconduct occurred. Qureshi and Sokobin (2015) note that the lag between actual misconduct and the associated customer complaint is usually less than a year but a regulatory action is often years later after a misconduct occurred.

aggregate shocks to misconduct (e.g., recessions), differences in demographics and labor market conditions in a given county at a point in time, or other heterogeneity in branch characteristics. Following Egan et al. (2019), we also control for the advisor's prior misconduct,[6] years of experience, and professional qualifications (e.g., whether or not she has passed a qualifying exam to be registered as an investment adviser). As financial advisors are legally required to hold regulatory licenses to engage in particular activities or to hold certain positions with a firm, an advisor's professional qualifications proxy for her role and job function within the advisory firm (Egan et al. 2019). Consistent with our prediction, we find that recession advisors are less likely to commit misconduct than their colleagues who work in the same firm, at the same location, and at the same point in time. Relative to the baseline of misconduct in the profession, recession advisors are about 10% less likely to commit misconduct.

Although the set of controls together with the set of high-dimensional fixed effects (i.e., *Firm* × *County* × *Year fixed effects*) in the baseline regression should largely capture differences across firms and adviser job functions, we conduct additional tests to ensure that the documented difference between recession and non-recession advisors is not entirely driven by differences in hiring firms or advisor quality. First, to understand whether and to what extent initial placement characteristics explain our baseline results, we add initial placement fixed effects (i.e., starting firm by starting location fixed effects) to our baseline specification. The results show that the difference in misconduct between recession and non-recession advisors, though reduced by a quarter, remains significant after the inclusion of these high-dimensional fixed effects. Thus, even for financial advisors who start their career in the same firm and at the same location, those who start during

[6] We control for an advisor's prior misconduct to ensure that the effect of early recessions is not subsumed by this observable advisor characteristic. Since an advisor's prior misconduct is also likely affected by the economic conditions at her job market entry, we drop this control in a robustness check. Our inferences remain unchanged.

recessions are less likely to commit misconduct than their peers who start during other times. Second, we use an advisor's current quality rating and assets under management to proxy for advisor quality (Egan et al. 2019), and pre-advisor criminal records to capture high-risk advisors (Law and Mills 2019). After including these two additional sets of advisor-level controls, the difference in misconduct between recession and non-recession advisors remains significant.

Overall, the documented relation between early economic conditions and advisor misconduct does not appear to be entirely driven by differences in initial placement or advisor quality. Thus, our evidence suggests a behavioral difference between recession and non-recession advisors. While this behavioral difference can be an outcome of either nature (i.e., through selection on unobservables) or nurture (i.e., through imprinting), our evidence consistently suggests that it is not an expected outcome entirely based on differences in hiring firms or observable advisor characteristics identified in the existing literature.

Next, we consider whether and how differences in opportunity to commit misconduct affect our results. First, we restrict our dataset to the set of currently active financial advisors that are in client-facing roles (i.e., we remove non-client-facing advisors who have fewer opportunities to engage in misconduct). We continue to find that recession advisors are less likely to engage in misconduct than non-recession advisors in this subset of client-facing advisors. In addition, we perform two subsample analyses. We find that the difference in misconduct between recession and non-recession advisors persists and remains similar in advisory firms regardless of their client base (i.e., retail versus non-retail). Moreover, we find that this difference in misconduct is magnified in the top 20 firms with the highest advisor misconduct rates. These results suggest that the difference in misconduct between recession and non-recession advisors reflects their underlying propensity to commit misconduct and this behavioral difference is magnified when there are more opportunities to do so.

We also perform analyses to ensure that our results are not driven by sample selection. One potential concern is that, if any newly hired advisor with misconduct was more likely to be fired in recessions than in other times, the pre-2007 recession advisors included in our sample would be biased toward those with no misconduct. To ensure that this sample selection does not bias our results, we repeat our analysis for different subsamples of financial advisors based on the period over which they joined the profession. First, we remove all advisors who joined before 1992 to focus on two waves of recession advisors (those who joined in 2001 or 2007-2009).[7] In a more restricted subsample, we remove all advisors who joined before 2002 so the comparison is between recession advisors who joined over 2007-2009 and non-recession advisors who joined after 2001.[8] We still find a significant difference in misconduct between recession and non-recession advisors in these subsamples.

Lastly, we perform several additional analyses to enrich our findings. First, textual analyses of customer complaints show that recession advisors are notably less likely to be accused of recommending risky investments, engaging in unauthorized transactions or fraud.[9] Second, we show that, within the same firm and at the same location, the misconduct of financial advisors is more likely to be reported in periods of adverse economic conditions.[10] In addition, we show that recession advisors are less likely to be reprimanded for misconduct than their colleagues in economic downturns, but such an effect ceases in good economic times. Third, we show that

[7] The three most recent recession periods are 1990-1991, 2001, and 2007-2009. The year 1992 is chosen to exclude the recession period 1990-1991.

[8] We cannot simply focus on the set of advisors who joined over 2007-2017 because recession advisors who joined over 2007-2009 are always more experienced than non-recession advisors who joined over 2010-2017. Only by including the subset of advisors who joined before 2007 allows us to separate the recession-exposure effect from the years-of-experience effect.

[9] In case of misconduct accusations with damages requested by clients, the amount of damages requested, settlements or damages granted does not depend on whether the accused individual is a recession advisor or not.

[10] In the main analysis discussed earlier, we have controlled for time-varying local conditions through *Firm* × *County* × *Year Fixed Effects*.

recession advisors, who commit less misconduct, are more likely to take the role of chief compliance officer or hold other leadership positions at firms with less tolerance for misconduct. Fourth, we repeat our main analyses for financial advisors who start their career during booms. Specifically, we divide all financial advisors into three groups: recession advisors, boom advisors, and other advisors who start their career in neither recessions nor booms. We then compare both recession advisors and boom advisors with the last group. We find that boom advisors are more likely to commit misconduct throughout their career than the benchmark group, and they are more likely to have misconduct records in economic downturns. These additional results provide further support to our conjecture on the link between early economic conditions and advisor misconduct.

Our paper makes two main contributions. First, our paper contributes to the growing literature on financial advisors by documenting the long-run impact of economic conditions on the market for financial advisors. Our results indicate that the composition of available financial advisors in the profession is partly shaped by earlier economic conditions. By comparing financial advisors who work in the same firm, at the same location and in the same point in time, but start in different economic environments, we identify economic conditions at career start as an important predictor of financial advisor misconduct besides firm culture and local norms documented in the literature (Dimmock, Gerken, and Graham 2018; Parsons, Sulaeman, and Titman 2018; Egan, Matvos, and Seru 2019; Pacelli 2019).[11]

Second, our paper contributes to the behavioral economics literature on the determinants of individual misconduct. Prior research mostly focuses on corporate executives and finds that financial misreporting is related to individual philosophy (Ge, Matsumoto, and Zhang 2011), optimism

[11] See also Mullainathan, Noeth, and Schoar (2012), Qureshi and Sokobin (2015), Foerster, Linnainmaa, Melzer, and Previtero (2017), Griffin, Kruger, and Maturana (2017), Gurun, Stoffman, and Yonker (2017, 2019), McCann, Qin, and Yan (2017), Egan, Matvos, and Seru (2018), Charoenwong, Kwan, and Umar (2019), Cheng, Qian, and Reeb (2019), Clifford and Gerken (2019), Dimmock, Gerken, and Van Alfen (2019), Egan (2019), Law and Mills (2019), and Cook et al. (2019).

(Davis, Ge, Matsumoto, and Zhang 2015), materialism (Davidson, Dey, and Smith 2015; Bushman, Davidson, Dey, and Smith 2018), narcissism (Ham, Lang, Seybert and Wang 2017), and corporate culture (Graham, Grennan, Harvey, and Rajgopal 2018, 2019). Our paper builds on related work that studies on how labor markets are shaped by cohort effects (e.g., Oyer 2008; Malmendier, Tate, and Yan 2011; Schoar and Zuo 2017) and early career experiences (Shue 2013; Benmelech and Frydman 2015). While this prior research focuses on CEOs and corporate decisions, we study a broad sample of non-executive financial advisors in the investment industry and examine the relation between economic conditions at an advisor's job market entry and her professional conduct in the long-run. Our findings demonstrate that economic conditions impose a significant constraint on the types of financial advisors who are ultimately available in the profession.

The remainder of the paper is organized as follows. Section 2 briefly discusses the institutional background of the financial advisory industry and FINRA. Section 3 describes the data and the summary statistics of the variables used in our analyses. Section 4 explains our research methods and presents the empirical results. We conclude in Section 5.

2. Institutional Background

In the United States, all advisory firms and their employees in the securities business must register with the Financial Industry Regulatory Authority (FINRA) prior to carrying out business operations. FINRA (https://www.finra.org) was created in 2007 through the consolidation of the National Association of Securities Dealers and the member regulation, enforcement and arbitration operations of the New York Stock Exchange. FINRA is a self-regulatory not-for-profit organization authorized by Congress to write and enforce rules governing the activities of all registered advisory

firms and financial advisors,[12] foster market transparency, and educate investors. As of 2017, FINRA has a total of more than 3,500 employees across 16 offices in the United States, and there are 630,132 financial advisors in 3,726 advisory firms registered with FINRA.

Investors who believe that they have been treated unfairly by an advisory firm or its employees can file complaints with FINRA to recover their financial losses. FINRA is empowered to take disciplinary actions against advisors and their firms (e.g., fines, suspension, or permanent expulsion). FINRA Rule 4513 defines a customer complaint as "any grievance by a customer or any person authorized to act on behalf of the customer involving the activities of the member or a person associated with the member in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer." A customer complaint can be resolved through mediation if both sides agree or arbitration. Over 80% of mediations lead to settlements. In the case of arbitration, the advisor or its firm usually offers to settle prior to the arbitration meeting which tends to be lengthy and costly. In the event of an unreconciled dispute, the FINRA arbitration panel will determine the amount of granted damages based on all available evidence, where the amount granted is generally a small fraction of the original amount requested by investors. Around 40% of customer complaints are withdrawn, denied, or closed without action.

As part of the FINRA registration requirement, all financial advisors have to file Form U4 (Uniform Application for Security Industry Registration or Transfer) with FINRA. Each Form U4 contains an advisor's identifying information (e.g. name, social security number), employment history (including career starting date), professional qualifications, and disclosure events (e.g., customer complaints, arbitration, criminal records, personal bankruptcy, civil litigation, and other

[12] FINRA reports that "the term financial advisor is a generic term that usually refers to a broker (or, to use the technical term, a registered representative)." A broker is defined in the Securities and Exchange Act 1934 as "any person engaged in the business of effecting transactions in securities for the account of other."

disciplinary actions).[13] Financial advisors are obligated to continually update or amend Form U4 no later than 30 days after learning disclosure events. Advisors who willfully fail to timely update Form U4 are subject to FINRA's disciplinary actions (such as fines and suspension).

FINRA classifies disclosure events into twenty-three categories ranging from criminal offenses to customer disputes. Not all of these FINRA's disclosure categories are related to wrongdoing, and only six of them are relatively clear indications of misconduct (Egan et al. 2019): Customer Dispute – Settled, Regulatory – Final, Employment Separation after Allegations, Customer Dispute – Award/Judgment, Criminal – Final Disposition, and Civil – Final. Other disclosure categories are not necessarily indicative of misconduct. For example, "Financial – Final" could result from a financial advisor's personal bankruptcy. Neither do all customer disputes represent evidence of misconduct as some disputes were resolved in favor of the financial advisor (Customer Dispute – Denied) or withdrawn by the customer (Customer Dispute – Withdrawn) and the wrongdoings of advisors in some disputes are still to be determined (Customer Dispute – Pending). The former six categories cover regulatory or criminal offenses, internal investigations, and customer disputes that were resolved against the advisor, and defining misconduct based on these six categories is thus conservative (Egan et al. 2019).

3. Data and Descriptive Statistics

Our main sample comes from the historical Form U4 filings submitted by financial advisors as part of their registration and licensing process with FINRA. FINRA centrally stores these filings in its BrokerCheck website, and these data (without sensitive personal information such as the social security number) are made publicly available in the form of BrokerCheck Reports. We obtain these

[13] FINRA stipulates that "all individuals registered to sell securities or provide investment advice are required to disclose customer complaints and arbitrations, regulatory actions, employment terminations, bankruptcy filings, and criminal or judicial proceedings."

BrokerCheck Reports for all 1.3 million financial advisors who were registered at any point in time between January 2007 and July 2017. Approximately 640,000 of these advisors remained active as of July 2017. The advisors in our sample began their career in the profession as early as 1946. We also obtain 16,242 BrokerCheck Reports for advisory firms that were either previously registered or remained active as of July 2017. Our sample consists of an unbalanced panel of financial advisors over the ten-year period from 2007 to 2017. This advisor-by-year panel only includes the active years of an advisor over the period from 2007 to 2017. For example, for an advisor who joined the profession in 2000 and exited in 2010, this panel includes four annual observations (over 2007 to 2010) for this advisor. Inactive years are excluded because an inactive advisor cannot commit misconduct and is not directly comparable to an active advisor. While our sample includes advisors who joined the profession before 2007 (and remained active as of 2007), their pre-2007 observations are not included because we do not observe the full set of active advisors for years before 2007 (i.e., those who joined and exited before 2007 are unobservable in the data). For each year over the sample period 2007-2017, we observe the full set of active advisors in that year. This sampling approach follows prior research (e.g., Egan et al. 2019; Law and Mills 2019).

Table 1 reports the descriptive statistics for the main variables used in this study in the order of their appearance in the subsequent tables. Detailed definitions of all variables are in Appendix A. On average, 12.3% of advisor-year observations come from advisors who start their career during NBER recessions. The overall misconduct rate is 0.557%, which is similar to 0.60% reported in Egan et al. (2019) over an earlier period from 2005 to 2015.

The last two columns of Table 1 report the descriptive statistics for advisors hired in recession versus non-recession periods, respectively. The overall misconduct rate is higher for non-recession advisors than for recession advisors (0.561% versus 0.526%), as predicted. Consistent with the existence of selection, recession and non-recession advisors included in our sample differ in

several observable dimensions. For example, recession advisors tend to hold different types of professional qualifications than non-recession advisors. The financial advisory industry is highly regulated, and financial advisors are legally required to hold regulatory licenses to engage in particular activities or to hold certain positions within a firm (Egan et al. 2019). Thus, an advisor's professional qualifications capture her role and job function within the advisory firm. The list of common professional qualifications are (a) the Investment Adviser Examination (Series 65/66), (b) the Securities Agent State Law Examination (Series 63), (c) the General Securities Representative Examination (Series 7), (d) the Investment Company Product Representative Examination (Series 6), and (e) the General Securities Principal Examination (Series 24). These exams qualify financial advisors to manage different types of accounts and assets. The Series 65 and 66 exams qualify individuals to operate as investment advisers. The Series 63 exam covers state security regulations. The Series 7 exam qualifies individuals to sell and trade any type of general securities products. The Series 6 exam qualifies an investment adviser to sell open-end mutual funds and variable annuities. The Series 24 exam qualifies an individual to operate in an officer or supervisory capacity at general securities firms. Thus, recession advisors appear to have different job functions than non-recession advisors.

Recession advisors also have a higher quality rating but a lower amount of assets under management than non-recession advisors. Moreover, recession advisors are less likely to work in the top 20 firms with the highest advisor misconduct rates. In Appendix B, we compare the initial and current placements of recession and non-recession advisors, and again find several differences. For example, recession advisors are less likely to start the career or work at a retail, prime brokerage, investment banking, or wealth management firm. Overall, recession advisors appear to be of higher quality and have fewer opportunities to commit misconduct than non-recession advisors.

These descriptive statistics for recession and non-recession advisors suggest that it is

important to control for these observable differences in our regression specification to ensure that the relation between early economic conditions and advisor misconduct is not entirely driven by the differences in hiring firms, advisor job functions and quality, and opportunities to commit misconduct.

4. Research Methods and Empirical Results

Our empirical analyses proceed as follows. We start by testing whether economic conditions at a financial advisor's career start predict her future misconduct throughout their career. We then conduct tests to assess whether differences in hiring firms, advisor quality, or opportunities to commit misconduct drive the relation between early economic conditions and advisor misconduct. We further examine whether this relation is magnified in firms with a higher tolerance for misconduct. We repeat our analyses in alternative subsamples of advisors to alleviate potential concerns about sample selection. Lastly, we conduct several additional analyses to enrich our main findings.

4.1 Professional Misconduct

In this section, we examine whether recession advisors are less likely to commit misconduct throughout their career than their colleagues. We estimate the following linear probability model:

$$Misconduct_{ijlt} = \alpha + \beta_1 Recession\ Advisor_i + X_{ijlt} + \lambda_{jlt} + \varepsilon_{ijlt} \quad (1)$$

The unit of observation is a financial advisor-year over the sample period 2007-2017. Following Egan et al. (2019), the dependent variable *Misconduct* measures the flow of new misconduct over a one-year period and is a dummy variable indicating that the advisor *i* at advisory firm *j* in county *l* had one or more misconduct records in year *t*.[14] The following disclosure

[14] Year *t* refers to the year when misconduct is reported, but not necessarily when it is committed. It is also worth noting that this measure of misconduct does not capture misconduct that goes undetected or unrecorded.

categories are counted as misconduct records: customer dispute (settled), regulatory (final), employment separation after allegation, customer dispute (award/judgment), criminal (final disposition), or civil (final).

The main independent variable is *Recession Advisor*, an indicator variable equal to one if an advisor's first job begins during an NBER recession. X is three sets of control variables that could be associated with the likelihood of professional misconduct. First, Egan et al. (2019) find that financial advisors with prior misconduct are much more likely to engage in new misconduct as the average financial advisor. Thus, we control for *Prior Misconduct*, which measures the stock of misconduct and is a dummy variable indicating if advisor i has a record of misconduct prior to year t. We include this variable as a control to ensure that the effect of *Recession Advisor* is not subsumed by this observable characteristic. Second, we control for *Years of Experience* (i.e., an advisor's number of years of experience in the profession) as Egan et al. (2019) show that the likelihood of professional misconduct is associated with an increase in experience. Third, we include a number of variables related to professional qualifications as in Egan et al. (2019), which proxy for the type of advising advisor i engages in.

We also include *Firm* × *County* × *Year Fixed Effects* (i.e., λ) in our regression specification to perform a clean comparison between recession advisors and their colleagues working in the same firm j, at the same location l, and in the same year t. This set of high-dimensional fixed effects absorbs a host of factors that can affect advisor misconduct, such as variations in firms' tolerance for misconduct, different business models (e.g., retail versus non-retail) or incentive structures that firms may have, heterogeneity in state- or county-level regulatory or enforcement conditions, any aggregate shocks to misconduct (e.g., recessions), differences in demographics and labor market conditions in a given county at a point in time, or other heterogeneity in branch characteristics (Dimmock et al. 2018; Egan et al. 2019). Thus, variables indicating the observable differences in

current advisory firms tabulated in Table 1 and Appendix B (e.g., *Retail*, *Top-20 Misconduct Firm*) are subsumed by this set of high-dimensional fixed effects. As the residuals are likely correlated within-firm, we cluster all standard errors at the firm-level.

Table 2 summarizes the results. In column 1, we regress *Misconduct* on *Recession Advisor* without controls or fixed effects. We find that the coefficient estimate on *Recession Advisor* is significantly negative. This suggests that on average financial advisors who start during recessions are less likely to commit misconduct throughout their career. In column 2, we control for *Firm* × *County* × *Year Fixed Effects*. We find that recession advisors are less likely to commit misconduct when compared with their colleagues working in the same firm, at the same location, and at the same point in time, as the coefficient estimate on *Recession Advisor* is significantly negative. In column 3, we further include a number of variables to control for the differences in prior misconduct, general experience, and professional qualifications. The coefficients on the control variables are consistent with Egan et al. (2019): advisors with past misconduct are more likely to engage in new misconduct; more experienced advisors are more likely to commit misconduct; advisors that hold a Series 65/66 or 63 exam qualification are more likely to be reprimanded for misconduct; and there is a negative relation between the total number of other qualifications an advisor holds and the probability of misconduct. Importantly, the coefficient estimate on *Recession Advisor* continues to be negative and statistically significant. Relative to the base rate of *Misconduct* of 0.557% in a given year, the estimate translates into an approximately 10% (=0.056÷0.557) lower likelihood of engaging in misconduct, which is economically meaningful. Overall, our results show that recession advisors are less likely to commit misconduct than other advisors, even after controlling for their past misconduct, experience and professional qualifications as well as time-varying heterogeneity in branch characteristics.

4.2 Hiring Firms and Advisor Quality

Although the set of controls together with the set of high-dimensional fixed effects (i.e., *Firm* × *County* × *Year fixed effects*) in the baseline regression in column 3 of Table 2 should largely capture differences across firms and adviser job functions, we conduct additional tests to ensure that the documented difference between recession and non-recession advisors is not entirely driven by differences in hiring firms or advisor quality.

Recessions might affect a financial advisor's initial placement, and this initial job allocation could have a long-term impact on her professional conduct. For example, retail hiring could slow down during recessions relative to institutional hiring, and higher-quality advisory firms could be more recession-proof and hire relatively more junior staff during recessions than lower-quality advisory firms. In addition, initial placements could also be associated with the caliber of financial advisors, where advisors with higher innate ability could get selected into larger and more prestigious advisory firms. To understand whether and to what extent initial placement characteristics explain our baseline results, in column 1 of Table 3, we add *Initial Placement Fixed Effects* (i.e., starting firm by starting location fixed effects) to the baseline specification. Variables indicating the observable differences in initial placements tabulated in Appendix B (e.g., *Retail*, *Prime Brokerage*, *Investment Banking*, or *Wealth Management*) are subsumed by this set of fixed effects. The results show that the difference in misconduct between recession and non-recession advisors, though reduced by a quarter, remains significant after the inclusion of these high-dimensional fixed effects. Thus, even for financial advisors who start their career in the same firm and at the same location, those who start during recessions are less likely to commit misconduct than their peers who start during other times.

In addition to between-firm differences in hiring patterns, the same advisory firm might be more selective and hire more higher-quality, lower-risk individuals during recessions than during

other times. To measure advisor quality, we supplement the FINRA dataset with additional advisor-level data from Discovery Data for currently active financial advisors.[15] Specifically, we use an advisor's current quality rating (i.e., an indicator variable equal to one if an advisor has had a Series 6 or 7 license for seven or more years and is currently registered in nine or more states) and assets under management (AUM) to proxy for advisor quality and productivity (Egan et al. 2019). Further, we use pre-advisor criminal records to capture high-risk advisors (Law and Mills 2019). In columns 2 to 4 of Table 3, we add each of these three variables to the baseline specification. Consistent with Egan et al. (2019), we find that higher-quality, more productive advisors are also more likely to have misconduct records (probably because they have more opportunities to commit misconduct). We also find that advisors with pre-advisor criminal records are more likely to engage in misconduct, consistent with Law and Mills (2019).[16] After including any of these additional advisor-level controls, the difference in misconduct between recession and non-recession advisors remains significant.[17] In column 5 of Table 3, we add these three variables along with *Initial Placement Fixed Effects* to the baseline regression, and our main results continue to hold.

Overall, the documented relation between early economic conditions and advisor misconduct does not appear to be entirely driven by differences in initial placement or observable advisor quality. Thus, we interpret this relation as evidence suggesting a behavioral difference between recession and non-recession advisors. While this behavioral difference can be an outcome of either nature (i.e., through selection on unobservables) or nurture (i.e., through imprinting), our evidence consistently suggests that it is not an expected outcome entirely based on differences in

[15] Egan et al. (2019) use the same data provided by Meridian-IQ which was acquired by Discovery Data in 2016.
[16] *Pre-Advisor Criminal Record* and *Prior Misconduct* are strongly correlated. Thus, in regressions where both *Pre-Advisor Criminal Record* and *Prior Misconduct* are included as explanatory variables, we code *Pre-Advisor Criminal Record* as one and *Prior Misconduct* as zero for observations when the original values of both variables equal one.
[17] The magnitude of the coefficient estimate on *Recession Advisor* in columns 2, 3, and 5 of Table 3 is not directly comparable to that in Table 2 because the samples used here are substantially reduced due to data availability.

hiring firms or observable advisor characteristics identified in the existing literature.

4.3 Opportunities to Commit Misconduct

"Fraud is a crime of opportunity." Some advisors may not have an opportunity to engage in misconduct due to either strict monitoring of their firms or their job assignment (e.g., a non-client-facing position). Thus, it is important to hold the opportunity to commit misconduct constant when comparing recession and non-recession advisors. The set of controls in the baseline specification should have captured obvious differences in opportunities to commit misconduct across firms and advisor job functions. In a further analysis, we restrict our dataset to the set of currently active financial advisors that are in client-facing roles (i.e., we remove non-client-facing advisors who have fewer opportunities to engage in misconduct). Following Egan et al. (2019), we determine whether an advisor is in a client-facing position using two separate definitions: (1) information from Discovery Data, and (2) the number of state registrations (Qureshi and Sokobin 2015). Qureshi and Sokobin (2015, p. 7) note that "based on its experience, FINRA staff believes that brokers with more than three state registrations generally deal with public investors." In columns 1 and 2 of Table 4, we restrict our dataset to the set of currently active financial advisors that are in client-facing roles based on either one of these two definitions. Using either definition, we find that, in the set of client-facing advisors, recession advisors are less likely to engage in misconduct than non-recession advisors.

Moreover, if the difference in misconduct between recession and non-recession advisors reflects their underlying propensity to commit misconduct, this difference is likely to be magnified when there are more opportunities to engage in misconduct. That is, there will be an interactive effect between an advisor's behavioral tendency to commit misconduct and the opportunity to do so. The results based on client-facing advisors suggest that the difference between recession and non-recession advisors is somewhat magnified in this subset of advisors (14.2% relative to the

baseline misconduct versus 10.3% in the baseline regression). We perform two additional subsample analyses to further examine this interactive effect. In columns 3 and 4 of Table 4, we re-estimate the baseline regression for retail and non-retail firms, respectively, where retail firms are those advisory firms that service retail clients (i.e., non-high-net worth individuals). While it might be easier to ensnare less sophisticated investors, defrauding high-net worth investors could be more profitable. We find that the difference in misconduct between recession and non-recession advisors persists and remains similar in advisory firms regardless of their client base (i.e., retail versus non-retail).[18] In columns 5 and 6, we divide sample advisory firms into two groups based on the percentage of advisors working for a firm that have been reprimanded for misconduct. Consistent with our prediction, we find that the effect of early recession on advisor misconduct (11.6% relative to the baseline misconduct) is magnified in the top 20 firms with the highest advisor misconduct rates.[19]

4.4 Alternative Samples

Panel A of Table 5 tabulates the number of sample advisors entering in each NBER recession or expansion period. A recession (or contraction) starts at the peak of a business cycle and ends at the trough, and an expansion covers the other part of the business cycle (from this trough to next peak).[20] The recession advisors included in our sample joined the profession in 11 different recession periods, though the majority joined in the two most recent recession periods (i.e., 2001 and 2007-2009). The non-recession advisors came from 12 different NBER expansion periods, with a significant proportion joined after the 1991 recession.

In the baseline specification, our sample (which was retrieved in July 2017) consists of a

[18] The difference between the two coefficient estimates on *Recession Advisor* in columns 3 and 4 is not statistically significant.
[19] The difference between the two coefficient estimates on *Recession Advisor* in columns 5 and 6 is statistically significant.
[20] See https://www.nber.org/cycles.html. The NBER notes that it "does not define a recession in terms of two consecutive quarters of decline in real GDP. Rather, a recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."

panel of all financial advisors who were registered at any point in time between January 2007 and July 2017. This dataset includes advisors who began their career in the profession as early as 1946 but does not include financial advisors who deregistered before 2007. Thus, our sample consists of (1) the full set of advisors who joined the profession between 2007 and 2017 and (2) the set of advisors who joined before 2007 and remained active as of 2007. We cannot simply focus on the set of advisors who joined over 2007-2017 because this period contains only one recession that occurs at the beginning of the sample period (i.e., 2007-2009). Thus, recession advisors who joined over 2007-2017 will always be more experienced than non-recession advisors who joined over 2007-2017. Including the subset of advisors who joined before 2007 allows us to separate recession exposure and years of experience given multiple cohorts of recession and non-recession advisors who joined the profession in different periods. As such, there exist non-recession advisors that are more or less experienced than recession advisors, which allows us to separate the years-of-experience effect from the recession-exposure effect.

However, one potential concern with this sample selection is that, if any newly hired advisor with misconduct was more likely to be fired in recessions than in other times,[21] the pre-2007 recession advisors (i.e., those who joined before 2007) included in our sample would be biased toward those with no misconduct. Appendix C shows the descriptive statistics for pre-2007 and post-2007 recession advisors, respectively. To ensure that this sample selection does not bias our results, we repeat our analysis for different subsamples of financial advisors based on the period over which they joined the profession.

First, we remove all advisors who joined before 1992 to focus on the subset of recession advisors who joined in 2001 or 2007-2009, and compare them with the subset of non-recession

[21] Mass layoffs in big law firms during the 2007-2009 financial crisis were heavily documented in the press. See, for example, "Recession Batters Law Firms, Triggering Layoffs, Closings" (*The Wall Street Journal*, January 26, 2009).

advisors who joined after the 1991 recession. As Panel A shows, these two subsets of advisors cover the majority of the sample advisors and are less likely to suffer from potential selection issue. Column 1 in Panel B shows that a significant difference in misconduct between recession and non-recession advisors remains in this subsample. In column 2 in Panel B, we further remove a subset of non-recession advisors who joined before 1997 (i.e., 10 years before the FINRA cutoff year of 2007) and our main results continue to hold. Lastly, we use a more restricted subsample where we remove all advisors who joined before 2002 so the comparison is between recession advisors who joined over 2007-2009 and non-recession advisors who joined after the 2001 recession. This subsample includes the full set of recession advisors who joined over 2007-2009 and there is no selection issue with the recession advisors. To the extent that the subset of non-recession advisors who joined before 2007 is more likely to include those with no misconduct, it biases against our prediction. The results in column 3 in Panel B show that our inference remains unchanged in this subsample.

4.5 Additional Analyses

We perform five additional analyses. First, to capture the nature of customer accusations, we conduct textual analyses of the allegations made by customers in their complaints filed with FINRA. Second, we examine the amount of damages requested, settlements or damages granted. Third, we test whether misconduct is more likely to be reported in economic downturns and whether recession advisors are less likely to be reprimanded for misconduct than their colleagues in those bad times. Fourth, we examine the long-run career outcome of recession advisors. Lastly, we repeat our main analyses for advisors who start in booms.

4.5.1 Textual Analyses of Customer Complaints

Our conjecture is that recession advisors exhibit a higher level of resistance for pursuing risky or even fraudulent investment behaviors than non-recession advisors. To examine this conjecture, we collect the allegations made by customers in their complaints filed with FINRA. We

conduct textual analyses based on the publicly available case summaries. We follow Egan et al. (2019) to construct the following eleven indicator variables to capture the nature of customer accusations: (1) risky investment, (2) misrepresentation, (3) unauthorized transaction, (4) fee or commission, (5) unsuitable, (6) omission of material fact, (7) fraud, (8) fiduciary duty, (9) negligence, (10) churning or excessive trading, and (11) other allegations. We follow our earlier analyses in column 3 of Table 2 with the same set of control variables and fixed effects, and replace *Misconduct* with each of these indicator variables.

We summarize the results in Table 6. First, compared with their colleagues in the same firm, at the same location, and at the same point in time, recession advisors are less likely to receive accusations across the whole spectrum of complaints except for *Churning or Excessive Trading*. In the ten categories with significant differences, the economic magnitudes of these differences are economically large from 6% to 34%. Second, we note that the most salient differences are about accusations of risky investment in column 1, unauthorized transactions in column 3, and fraud in column 7. The results show a 32-34% lower likelihood of customer accusations of selling risky investments, unauthorized transactions or fraud. As selling risky investments, unauthorized transactions, and fraud all fall into the category of active misconduct (than passive misconduct such as negligence or omission of material fact related to investments), these results indicate that recession advisors are less likely to commit intentional misconduct that causes investor harm.[22]

4.5.2 Damages and Settlements

Our earlier evidence shows that it is less likely for recession advisors to commit misconduct. A natural question is, conditional on observing professional misconduct, whether

[22] In Appendix D, we construct two alternative measures of misconduct. *Misconduct 1* is an indicator variable equal to one if there is a record on fraud or an unauthorized transaction in a given year. *Misconduct 2* is an indicator variable equal to one if there is a record on fraud or an unauthorized transaction in a given year, and the record is either from customer dispute (settled) or customer dispute (award/judgment). We replace *Misconduct* with these two alternative indicators of misconduct. Our main results continue to hold.

there is any difference in damages requested, settlements, or damages granted. We construct three variables to capture these different outcomes. *Damages Requested* is the total amount of damages requested by clients against an advisor in a given year. *Settlements* is the total amount of settlements between an advisor and her clients in a given year. *Damages Granted* is the total amount of damages granted to clients of an advisor after arbitration in a given year.

Panel A of Table 7 summarizes the results. First, recession advisors receive lower damages requested from their clients. In column 1, on average the damages requested by the clients of recession advisors are 1.1% lower in dollar value. The eventual settlement amount is also 0.8% lower, as the coefficient estimate on *Recession Advisor* in column 2 shows. However, we do not observe any difference in the damages granted by the FINRA panel, as the coefficient estimate on *Recession Advisor* is not significantly different from zero in column 3.

That being said, it is unclear whether these effects are driven by recession advisors' lower likelihood of committing misconduct. Thus, in panel B, we re-estimate these regressions for the sample with a positive *$ Damages Requested*.[23] None of the coefficient estimates of *Recession Advisors* are significant, and their signs fluctuate. Hence, in case of misconduct accusations with damages requested by clients, the amount of damages requested, settlements, or damages granted does not depend on whether the accused individual is a recession advisor or not. These results indicate that the benefit of having recession advisors for advisory firms mainly comes from fewer incidences of misconduct, but not alleviation in the damages sought by clients in subsequent dispute processes.

4.5.3 Local Economic Conditions

In this section, we examine whether financial misconduct is more likely to be reported in periods of adverse economic conditions and whether recession advisors are less likely to be

[23] 17,278 singleton observations are dropped after including *Firm* × *County* × *Year Fixed Effects*.

reprimanded for misconduct than their colleagues during those periods.

To examine these questions, we construct *Local Recession*, which is a variable equal to one if the real growth rate in gross state product (GSP) of a state in which an advisor works is in the lower tercile across all states in a given year. Column 1 of Table 8 shows that, within the same firm and at the same location, the misconduct of financial advisors is more likely to be reported in periods of adverse economic conditions. Relative to the baseline of 0.557%, the estimate translates into a 24% (=0.134÷0.557) higher likelihood of having a misconduct record.

In column 2 of Table 8, we construct an interaction term *Recession Advisor* × *Local Recession*, and regress *Misconduct* on *Recession Advisor*, this interaction term, and the same set of control variables. The coefficient estimate on *Recession Advisor* × *Local Recession* is significantly negative. Relative to the base rate of *Misconduct*, recession advisors are 20% (=0.111÷0.557) less likely to be reprimanded for misconduct than their colleagues during local recessions. The coefficient estimate on *Recession Advisor* is small and statistically insignificant. This is consistent with our earlier argument that investors are unlikely to file a complaint against any financial advisor in good times.

Overall, these results show that financial advisor misconduct is more likely to be reported in economic downturns, and recession advisors are less likely to be reprimanded for misconduct than their colleagues during those periods.

4.5.4 Career Outcomes

In this section, we examine the long-run career outcome of recession advisors. Egan et al. (2019) and Cook et al. (2019) show that firms that persistently engage in misconduct coexist with firms that have clean records. Egan et al. (2019) further show that advisors who are reprimanded for misconduct are more likely to leave their firms and move to less prestigious ones, and those involved with the most egregious incidents are more likely to exit the profession. Thus, one might expect that recession advisors, who commit less misconduct, are more likely to achieve leadership

positions at firms with less tolerance for misconduct.

To examine this, we construct four variables to capture the long-run career outcome of recession advisors. *Chief Compliance Officer at Top-20 Misconduct Firm* is an indicator variable equal to one if an advisor is the chief compliance officer of one of the top 20 firms with the highest advisor misconduct rates.[24] *Chief Compliance Officer at Other Firm* is an indicator variable equal to one if an advisor is the chief compliance officer of an advisory firm that does not belong to the top 20 firms with the highest advisor misconduct rates. *Top Executive at Top-20 Misconduct Firm* is an indicator variable equal to one if an advisor is a top executive of one of the top 20 firms with the highest advisor misconduct rates. *Top Executive at Other Firm* is an indicator variable equal to one if an advisor is a top executive of an advisory firm that does not belong to the top 20 firms with the highest advisor misconduct rates. Table 9 summarizes the results. Panel A presents the results for the full sample, and Panel B presents the results for the subset of advisors who joined over 2002-2017 (so it contains the full set of recession advisors who joined over 2007-2009). In both panels, we find that, compared with other advisors who start in the same firm and at the same location, recession advisors included in our sample are more likely to be a chief compliance officer or top executive at advisory firms with less tolerance for misconduct (columns 2 and 4).[25]

4.5.5 Boom Advisors

In our previous analyses, we compare advisors who start their career in recessions with their colleagues who start during other times, which include both booms and moderate expansion periods. In this section, we divide all financial advisors into three groups: recession advisors, boom

[24] The primary job function of the chief compliance officer in an advisory firm is to develop and maintain supervisory controls and ensure compliance with regulatory requirements. As the CEO style literature (e.g., Bertrand and Schoar 2003) shows that tone at the top has a significant influence on corporate policies, having a chief compliance officer is likely to clamp down professional misconduct among advisors.

[25] We also repeat the specification in column 3 of Table 2 after including these four variables as additional controls, and the coefficient estimate on *Recession Advisor* remains as -0.056 with a standard error of 0.012 (untabulated).

advisors, and other advisors who start their career in neither recessions nor booms. Specifically, we construct an indicator variable *Boom Advisor* that equals one if an advisor's first job begins during a boom. We classify a calendar month in an NBER expansion period as a boom if the percentage change in Standard and Poor's 500 during the past 36 months leading up to the month is in the upper tercile across all months over January 1946 to July 2017.[26] We augment our main regression model by including the indicator variable *Boom Advisor*. In this new set of analyses, those financial advisors who start their career during moderate expansion periods are used as the benchmark group, and we compare both recession advisors and boom advisors with them.

Table 10 summarizes the results. In column 1, we regress *Misconduct* on *Boom Advisor*, *Recession Advisor*, and the full set of control variables and *Firm* × *County* × *Year Fixed Effects* as in column 3 of Table 2. We find that the coefficient estimate on *Boom Advisor* is significantly positive. This suggests that on average, financial advisors who start during booms are more likely to commit misconduct throughout their career than their colleagues who start the career in neither booms nor recessions. Relative to the base rate of *Misconduct* of 0.557% in a given year, the estimate translates into an approximately 6% (=0.036÷0.557) higher likelihood of engaging in misconduct. The coefficient estimate on *Recession Advisor* continues to be negative and statistically significant (-0.042) but its magnitude is reduced by a quarter when compared with the coefficient estimate in column 3 of Table 2 (-0.056). This latter result is expected as the benchmark group in Table 2 includes those boom advisors who are more likely to commit misconduct than other advisors.

In column 2 of Table 10, we repeat the analysis of Table 8 after including *Boom Advisor* and *Boom Advisor* × *Local Recession* as additional independent variables. The coefficient estimate on *Boom*

[26] The NBER dating database (https://www.nber.org/cycles.html) classifies a month as either in a recession or expansion period. We thus rely on stock market performance to further decompose an NBER expansion period into a boom and moderate expansion period. The choice of past 36 months is somewhat arbitrary but not selective. Our inferences are unchanged when past 24 or 48 months are used instead.

Advisor × *Local Recession* is significantly positive. Relative to the base rate of *Misconduct*, this translates into a 11% (=0.062÷0.557) higher likelihood of reprimanding boom advisors (as opposed to the benchmark group) for misconduct during local recessions.

Overall, these results demonstrate that, compared with their colleagues who start in neither booms nor recessions, boom advisors are more likely to commit misconduct while recession advisors are less likely to do so throughout their career. During economic downturns, boom advisors are more likely while recession advisors are less likely to be reprimanded for misconduct than their colleagues. These results on boom advisors contrast clearly with our earlier results on recession advisors and provide further support to our conjecture on the long-run impact of economic conditions at a financial advisor's career start. At career start, boom advisors are exposed to an environment with loose oversight and monitoring. They also have greater opportunities to learn fraud techniques from their colleagues and develop this type of task-specific human capital. In addition, candidates with more aggressive risk appetite may be more likely to join the financial advisory industry in booms. As a result of these selection and imprinting effects, boom advisors behave differently from their colleagues who start the career in other times.

5. Conclusion

We study the long-term impact of economic conditions on the market for financial advisors. We find that recession advisors (i.e., financial advisors who start during recessions) are about 10% less likely to commit misconduct throughout their career than their colleagues working in the same firm, at the same location, and at the same point in time. We show that this relation between early economic conditions and advisor misconduct remains after controlling for differences in hiring firms, advisor job functions and quality, and opportunities to commit misconduct. Collectively, our evidence suggests a behavioral difference between recession and non-recession advisors. While this behavioral difference can be an outcome of either nature (i.e., through selection on unobservables)

or nurture (i.e., through imprinting), our evidence consistently suggests that it is not an expected outcome entirely based on differences in observable characteristics identified in the existing literature.

Our study has broad implications for the financial advisory industry. Our results show that economic conditions change the composition of available financial advisors at a future point in time. One immediate implication is that after extended periods of economic expansions, the available pool of financial advisors in the profession will be tilted toward those who are more likely to commit misconduct. This evidence presents implications for investors and regulators in the early detection of high-risk advisors. To increase the supply of financial advisors who are less likely to commit misconduct, it is essential to impose strict screening criteria in selection and provide training and monitoring at the start of their career. Our findings suggest that this is an important step even when junior advisors only deal with a small client base.

References

Akerlof, G., and R. J. Shiller. 2009. *Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism*. Princeton University Press: New Jersey.

Benmelech, E., and C. Frydman. 2015. Military CEOs. *Journal of Financial Economics* 117 (1): 43–59.

Bertrand, M., and A. Schoar. 2003. Managing with style: The effect of managers on firm policies. *Quarterly Journal of Economics* 118 (4): 1169–1208.

Bureau of Labor Statistics, U.S. Department of Labor. 2018. *Occupational Outlook Handbook*, Personal Financial Advisors, on the Internet at https://www.bls.gov/ooh/business-and-financial/personal-financial-advisors.htm (visited August 18, 2018).

Bushman, R. M., R. Davidson, A. Dey, and A. Smith. 2018. Bank CEO materialism: Risk controls, culture and tail risk. *Journal of Accounting and Economics* 65 (1): 191–220.

Campbell, D., M. Loumioti, and R. Wittenberg-Moerman. 2019. Making sense of soft information: Interpretation bias and loan quality. Forthcoming at *Journal of Accounting and Economics*.

Charoenwong, B., A. Kwan, and T. Umar. 2019. Does regulatory jurisdiction affect the quality of investment-adviser regulation? Forthcoming at *American Economic Review*.

Cheng, J., W. Qian, and D. M. Reeb. 2019. The ownership complaint gap: mutual vs. stock intermediaries. Working paper.

Clement, M., and K. K. F. Law. 2018. Labor market dynamics and analyst ability. Working paper.

Clifford, C. P., and W. C. Gerken. 2019. Investment in human capital and labor mobility: Evidence from a shock to property rights. Working paper.

Cook, J. A., K. M. Johnstone, Z. T. Kowaleski, M. Minnis, and A. Sutherland. 2019. Auditors are known by the companies they keep. Working paper.

Davidson, R., A. Dey, and A. Smith. 2015. Executives' "off-the-job" behavior, corporate culture, and financial reporting risk. *Journal of Financial Economics* 117 (1): 5–28.

Davis, A. K., W. Ge, D. Matsumoto, and J. L. Zhang. 2015. The effect of manager-specific optimism on the tone of earnings conference calls. *Review of Accounting Studies* 20 (2): 639–673.

Dimmock, S. G., W. C. Gerken, and N. P. Graham. 2018. Is fraud contagious? Co-worker influence on misconduct by financial advisors. *Journal of Finance* 73 (2018): 1417–1450.

Dimmock, S. G., W. C. Gerken, and T. D. Van Alfen. 2019. Real estate shocks and financial advisor misconduct. Working paper.

Egan, Mark. 2019. Brokers vs. retail investors: Conflicting interests and dominated products. *Journal of Finance* 74 (3): 1217–1260.

Egan, M., G. Matvos, and A. Seru. 2018. When Harry Fired Sally: The double standard in punishing misconduct. Working paper.

Egan, M., G. Matvos, and A. Seru. 2019. "The Market for Financial Adviser Misconduct." *Journal of Political Economy* 127 (1): 233–295.

Foerster, S., J. Linnainmaa, B. Melzer, and A. Previtero. 2017. Retail financial advice: Does one size fit all? *Journal of Finance* 72 (4): 1441–1482.

Galbraith, J. K. 1954. *The Great Crash of 1929*. Houghton Mifflin Harcourt: New York.

Ge, W., D. Matsumoto, and J. L. Zhang. 2011. Do CFOs have style? An empirical investigation of the effect of individual CFOs on accounting practices. *Contemporary Accounting Research* 28 (4): 1141–1179.

Gibbons, R., and M. Waldman. 2004. Task-specific human capital. *American Economic Review* 94 (2): 203–207.

Gibbons, R., and M. Waldman. 2006. Enriching a theory of wage and promotion dynamics inside firms. *Journal of Labor Economics* 24 (1): 59–108.

Graham, J. R., J. Grennan, C. R. Harvey, and S. Rajgopal. 2018. Corporate culture: The interview evidence. Working paper.

Graham, J. R., J. Grennan, C. R. Harvey, and S. Rajgopal. 2019. Corporate culture: Evidence from the field. Working paper.

Greene, W. 2004. The behaviour of the maximum likelihood estimator of limited dependent variable models in the presence of fixed effects. *Econometrics Journal* 7 (1): 98–119.

Griffin, J. M., S. Kruger, and G. Maturana. 2017. Do personal ethics influence corporate ethics? Working paper.

Gurun, U. G., N. Stoffman, S. E. Yonker. 2017. Trust busting: The effect of fraud on investor behavior. *Review of Financial Studies* 31 (4): 1341–1376.

Gurun, U. G., N. Stoffman, S. E. Yonker. 2019. Unlocking clients. Working paper.

Ham, C., M. H. Lang, N. Seybert, and S. Wang. 2017. CFO narcissism and financial reporting quality. *Journal of Accounting Research* 55 (5): 1089–1135.

He, X., S. Kothari, T. Xiao, and L. Zuo. 2018. Long-term impact of economic conditions on auditors' judgment. *The Accounting Review* 93 (6): 203-229.

Kindleberger, C.P., and R. Z. Aliber. 2005. *Manias, Panics, and Crashes: A History of Financial Crises*. John Wiley & Sons: New York.

Law, K. K. F., and L. F. Mills. 2019. Financial gatekeepers and investor protection: Evidence from criminal background checks. *Journal of Accounting Research* 57 (2): 491-543.

Malmendier, U., G. Tate, and J. Yan. 2011. Overconfidence and early-life experiences: The effect of managerial traits on corporate financial policies. *Journal of Finance* 66 (5): 1687–1733.

Marquis, C., and A. Tilcsik. 2013. Imprinting: Toward a multilevel theory. *Academy of Management Annals* 7 (1): 193–243.

McCann, C., C. Qin, and M. Yan. 2016. *How Widespread and Predictable is Stock Broker Misconduct*. Securities Litigation and Consulting Group.

Mullainathan, S., M. Noeth, and A. Schoar. 2012. The market for financial advice: An audit study. Working paper.

O'Hara, M. 2016. *Something for Nothing: Arbitrage and Ethics on Wall Street*. W. W. Norton & Company: New York.

Oyer, P. 2006. Initial labor market conditions and long-term outcomes for economists. *Journal of Economic Perspectives* 20 (3): 143–160.

Oyer, P. 2008. The making of an investment banker: Stock market shocks, career choice, and lifetime income. *Journal of Finance* 63 (6): 2601–2628.

Pacelli, J. 2019. Corporate culture and analyst catering. *Journal of Accounting and Economics* 67 (1): 120–143.

Parsons, C. A., J. Sulaeman, and S. Titman. 2018. The geography of financial misconduct. *Journal of Finance* 73 (5): 2087–2137.

Povel, P., R. Singh, and A. Winton. 2007. Booms, busts, and fraud. *Review of Financial Studies* 20 (4): 1219–1254.

Qureshi, H., and J. Sokobin. 2015. Do investors have valuable information about brokers? Working paper.

Schein, E. 1971. The individual, the organization, and the career: A conceptual scheme. *Journal of Applied Behavioral Science* 7 (4): 401–426.

Schoar, A., and L. Zuo. 2016. Does the market value CEO styles? *American Economic Review* 106 (5): 262–266.

Schoar, A., and L. Zuo. 2017. Shaped by booms and busts: How the economy impacts CEO careers and management styles. *Review of Financial Studies* 30 (5): 1425–1456.

Shiller, R. J. 2005. *Irrational Exuberance*. Princeton University Press: New Jersey.

Shue, K. 2013. Executive networks and firm policies: Evidence from the random assignment of MBA peers. *Review of Financial Studies* 26 (6): 1401–1442.

Soltes, E. F. 2016. *Why They Do It: Inside the Mind of the White-Collar Criminal*. Public Affairs: New York.

Appendix A
Variable Definitions

Variables	**Descriptions**
Recession Advisor	An indicator variable equal to one if an advisor's first job begins during a recession. [Source: FINRA, NBER]
Misconduct	An indicator variable equal to one if there is a misconduct record for an advisor in a given year. Misconduct record includes one of the following six types of records: (1) customer dispute – settled, (2) regulatory – final, (3) employment separation after allegations, (4) customer dispute – award/judgment, (5) criminal – final disposition, and (6) civil – final. [Source: FINRA]
Prior Misconduct	An indicator variable equal to one if there is a prior *Misconduct*. [Source: FINRA]
Years of Experience	An advisor's number of years of experience in the profession. [Source: FINRA]
Investment Adviser Exam	An indicator variable equal to one if an advisor passes the Investment Adviser Examination (Series 65/66). [Source: FINRA]
Securities Agent State Law Exam	An indicator variable equal to one if an advisor passes the Securities Agent State Law Examination (Series 63). [Source: FINRA]
General Securities Representative Exam	An indicator variable equal to one if an advisor passes the General Securities Representative Examination (Series 7). [Source: FINRA]
Investment Company Product Representative Exam	An indicator variable equal to one if an advisor passes the Investment Company Product Representative Examination (Series 6). [Source: FINRA]
General Securities Principal Exam	An indicator variable equal to one if an advisor passes the General Securities Principal Examination (Series 24). [Source: FINRA]
Number of Other Qualifications	The number of other qualifications possessed by an advisor. [Source: FINRA]
Advisor Quality	An indicator variable equal to one if an advisor has had a Series 6 or 7 license for seven or more years and is currently registered in nine or more states. [Source: Discovery Data]
Assets under Management	An advisor's assets under management. [Source: Discovery Data]
Pre-Advisor Criminal Record	An indicator variable equal to one if there is a criminal charge before an individual becomes a financial advisor. [Source: FINRA]
Client-Facing Advisor	An indicator variable equal to one if an advisor is a client-facing advisor. [Source: FINRA and Discovery Data]
Retail	An indicator variable equal to one if an advisory firm serves retail investors. [Source: Discovery Data]
Top-20 Misconduct Firms	An indicator variable equal to one if an advisory firm is one of the twenty firms with the highest employee misconduct rates. [Source: Egan, Matvos, and Seru (2019)]
Risky Investment	An indicator variable equal to one if there is a customer complaint about highly risky investment in a given year. [Source: FINRA]
Misrepresentation	An indicator variable equal to one if there is a customer complaint about misrepresentation in a given year. [Source: FINRA]
Unauthorized Transaction	An indicator variable equal to one if there is a customer complaint about an unauthorized transaction in a given year. [Source: FINRA]
Fee or Commission	An indicator variable equal to one if there is a customer complaint about an advisor's fee or commission in a given year. [Source: FINRA]

Appendix A

Variable Definitions – *Continued*

Variables	Descriptions
Unsuitable	An indicator variable equal to one if there is a customer complaint about the unsuitability of investment product in a given year. [Source: FINRA]
Omission of Material Fact	An indicator variable equal to one if there is a customer complaint about the omission of material fact in a given year. [Source: FINRA]
Fraud	An indicator variable equal to one if there is a customer complaint about fraud in a given year. [Source: FINRA]
Fiduciary Duty	An indicator variable equal to one if there is a customer complaint about fiduciary duty in a given year. [Source: FINRA]
Negligence	An indicator variable equal to one if there is a customer complaint about negligence in a given year. [Source: FINRA]
Churning or Excessive Trading	An indicator variable equal to one if there is a customer complaint about churning or excessive trading in a given year [Source: FINRA]
Other Allegations	An indicator variable equal to one if there is a customer complaint that is not about unsuitable investment, misrepresentation, unauthorized transactions, omission of material fact, fee or commission, fraud, fiduciary duty, negligence, risky investment, and churning or excessive trading. [Source: FINRA]
$ Damages Requested	The total amount of damages requested by clients against an advisor in a given year. [Source: FINRA]
$ Settlements	The total amount of settlements between an advisor and her clients in a given year. [Source: FINRA]
$ Damages Granted	The total amount of damages granted to clients of an advisor after arbitration in a given year. [Source: FINRA]
Local Recession	An indicator variable equal to one if the real growth rate in gross state product (GSP) of a state in which an advisor works is in the lower tercile across all states in a given year. [Source: Bureau of Economic Analysis]
Chief Compliance Officer at Top-20 Misconduct Firm	An indicator variable equal to one if an advisor is the chief compliance officer of one of the top 20 firms with the highest advisor misconduct rates. [Source: Discovery Data and Egan, Matvos, and Seru (2019)]
Chief Compliance Officer at Other Firm	An indicator variable equal to one if an advisor is the chief compliance officer of an advisory firm that does not belong to the top 20 firms with the highest advisor misconduct rates. [Source: Discovery Data and Egan, Matvos, and Seru (2019)]
Top Executive at Top-20 Misconduct Firm	An indicator variable equal to one if an advisor is a top executive of one of the top 20 firms with the highest advisor misconduct rates. [Source: Discovery Data and Egan, Matvos, and Seru (2019)]
Top Executive at Other Firm	An indicator variable equal to one if an advisor is a top executive of an advisory firm that does not belong to the top 20 firms with the highest advisor misconduct rates. [Source: Discovery Data and Egan, Matvos, and Seru (2019)]
Boom Advisor	An indicator variable equal to one if an advisor's first job begins during a boom. [Source: FINRA, NBER, WRDS]

Appendix B

Summary Statistics of Initial and Current Placements

This table reports the summary statistics of initial and current placements for recession and non-recession advisors, respectively.

	Initial Placements (at Advisor Level)			Current Placements (at Advisor-Year Level)		
	Recession Advisors	Non-Recession Advisors	Obs.	Recession Advisors	Non-Recession Advisors	Obs.
Firm Types	(1)	(2)	(3)	(4)	(5)	(6)
Retail	0.581	0.597	1,117,447	0.716	0.725	6,894,718
Top-20 Misconduct Firm	0.088	0.088	1,117,447	0.140	0.146	6,894,718
Bank	0.130	0.144	1,117,447	0.199	0.204	6,894,718
Discount Broker	0.043	0.049	1,117,447	0.056	0.057	6,894,718
Independent	0.094	0.096	1,117,447	0.140	0.154	6,894,718
Insurance	0.207	0.202	1,117,447	0.199	0.190	6,894,718
Investment Banking	0.248	0.273	1,117,447	0.326	0.343	6,894,718
Prime Brokerage	0.140	0.176	1,117,447	0.192	0.212	6,894,718
Wealth Management	0.561	0.578	1,117,447	0.691	0.701	6,894,718

Appendix C

Summary Statistics for Pre-2007 and Post-2007 Recession Advisors

This table reports the mean of various variables for recession advisors who joined before 2007 (i.e., pre-2007) and in/after 2007 (i.e., post-2007), respectively.

	Recession Advisors (Pre-2007)	Recession Advisors (Post-2007)
Table 2	(1)	(2)
Misconduct %	0.683	0.407
Prior Misconduct %	7.757	2.761
Years of Experience	16.650	4.489
Investment Adviser Exam	0.459	0.406
Securities Agent State Law Exam	0.770	0.588
General Securities Rep. Exam	0.703	0.658
Invest. Company Product Rep. Exam	0.393	0.395
General Securities Principal Exam	0.171	0.065
Number of Other Qualifications	0.547	0.225
Table 3		
Advisor Quality	0.579	0.516
Misconduct %	0.709	0.260
Assets under Management (in $mil)	110.326	79.619
Misconduct %	0.775	0.291
Pre-Advisor Criminal Record	0.017	0.021
Misconduct %	0.683	0.407
Table 4		
Client-Facing Advisor		
Based on Discovery Data	0.792	0.774
Based on Qureshi & Sokobin	0.496	0.460
Retail	0.743	0.695
Top-20 Misconduct Firms	0.162	0.123

Appendix C

Summary Statistics for Pre-2007 and Post-2007 Recession Advisors

	Recession Advisors (Pre-2007)	Recession Advisors (Post-2007)
Table 6	(1)	(2)
Risky Investment %	0.065	0.009
Misrepresentation %	0.311	0.046
Unauthorized Transaction %	0.068	0.013
Fee or Commission %	0.086	0.017
Unsuitable %	0.245	0.050
Omission of Material Fact %	0.093	0.021
Fraud %	0.030	0.006
Fiduciary Duty %	0.066	0.010
Negligence %	0.117	0.031
Churning or Excessive Trading %	0.076	0.011
Other Allegations %	0.296	0.063
Table 7		
$ Damages Requested	6,555	1,380
$ Settlements	2,097	84
$ Damages Granted	108.0	6.9
$ Damages Requested (>$0)	1,751,125	1,943,284
$ Settlements	476,847	44,550
$ Damages Granted	32,987	9,415
Table 8		
Local Recession	0.360	0.366
Table 9		
Chief Compliance Officer %		
at Top-20 Misconduct Firm	0.206	0.210
at Other Firm	1.561	1.122
Top Executive %		
at Top-20 Misconduct Firm	0.117	0.055
at Other Firm	2.135	1.203

Appendix D
Alternative Measures of Misconduct

This table reports the coefficient estimates of linear probability model regressions. Each observation is at the advisor-year level. *Misconduct 1* is an indicator variable equal to one if there is a record on fraud or an unauthorized transaction in a given year. *Misconduct 2* is an indicator variable equal to one if there is a record on fraud or an unauthorized transaction in a given year and the record is either from customer dispute – settled or customer dispute – award/judgment. *Recession Advisor* is an indicator variable equal to one if an advisor's first job begins during a recession. The economic effects are computed by dividing the coefficient estimates of *Recession Advisor* by the mean of the dependent variable. Standard errors clustered at the firm-level are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

	Dependent variables:	
	Misconduct 1	*Misconduct 2*
Independent variables	(1)	(2)
Recession Advisor	-0.013***	-0.012***
	(0.003)	(0.003)
Control variables	Identical to those in column 3 of Table 2	
Firm × County × Year Fixed Effects	Yes	Yes
Observations	6,894,718	6,894,718
R-squared	0.098	0.097
Economic effect of *Recession Advisor*	-22.5%	-23.9%

Table 1

Summary Statistics

This table reports the summary statistics for the variables in this study. Detailed definitions of all variables are in Appendix A.

Variables	Mean	SD	P25	P50	P75	Obs.	Recession Advisors	Non-Recession Advisors
Table 2	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Recession Advisor	0.123	0.328	0	0	0	6,894,718	1	0
Misconduct %	0.557	7.441	0	0	0	6,894,718	0.526	0.561
Prior Misconduct %	5.557	22.908	0	0	0	6,894,718	0.049	0.056
Years of Experience	11.236	8.174	4	10	16	6,894,718	9.734	11.447
Investment Adviser Exam	0.425	0.494	0	0	1	6,894,718	0.429	0.424
Securities Agent State Law Exam	0.731	0.443	0	1	1	6,894,718	0.667	0.740
General Securities Rep. Exam	0.681	0.466	0	1	1	6,894,718	0.677	0.682
Invest. Company Product Rep. Exam	0.399	0.490	0	0	1	6,894,718	0.394	0.399
General Securities Principal Exam	0.138	0.345	0	0	0	6,894,718	0.111	0.142
Number of Other Qualifications	0.430	0.788	0	0	1	6,894,718	0.364	0.439
Table 3								
Advisor Quality	0.523	0.499	0	1	1	2,529,627	0.549	0.520
Misconduct %	0.575	7.562	0	0	0	2,529,627	0.491	0.586
Assets under Management (in $mil)	105.32	236.72	10	50	100	1,464,832	98.54	106.19
Misconduct %	0.708	8.385	0	0	0	1,464,832	0.589	0.724
Pre-Advisor Criminal Record	0.018	0.132	0	0	0	6,894,718	0.019	0.017
Misconduct %	0.557	7.441	0	0	0	6,894,718	0.526	0.561

Table 1

Summary Statistics – *Continued*

Variables	Mean	SD	P25	P50	P75	Obs.	Recession Advisors	Non-Recession Advisors
Table 4	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client-Facing Advisor								
Based on Discovery Data	0.770	0.421	1	1	1	6,894,718	0.782	0.768
Based on Qureshi & Sokobin	0.391	0.488	0	0	1	6,894,718	0.363	0.395
Retail	0.724	0.447	0	1	1	6,894,718	0.716	0.725
Top-20 Misconduct Firms	0.145	0.352	0	0	0	6,894,718	0.140	0.146
Table 6								
Risky Investment %	0.046	2.148	0	0	0	6,894,718	0.033	0.048
Misrepresentation %	0.175	4.180	0	0	0	6,894,718	0.160	0.210
Unauthorized Transaction %	0.066	2.570	0	0	0	6,894,718	0.037	0.047
Fee or Commission %	0.080	2.832	0	0	0	6,894,718	0.047	0.058
Unsuitable %	0.204	4.510	0	0	0	6,894,718	0.134	0.181
Omission of Material Fact %	0.056	2.372	0	0	0	6,894,718	0.052	0.068
Fraud %	0.045	2.130	0	0	0	6,894,718	0.016	0.021
Fiduciary Duty %	0.052	2.277	0	0	0	6,894,718	0.034	0.045
Negligence %	0.044	2.094	0	0	0	6,894,718	0.068	0.082
Churning or Excessive Trading %	0.020	1.423	0	0	0	6,894,718	0.039	0.054
Other Allegations %	0.195	4.407	0	0	0	6,894,718	0.163	0.199
Table 7								
$ Damages Requested	5,256	1,715,915	0	0	0	6,894,718	3,612	5,486
$ Settlements	1,958	950,329	0	0	0	6,894,718	952	2,099
$ Damages Granted	41	20,466	0	0	0	6,894,718	50	40
$ Damages Requested (>$0)	1,697,365	30,833,630	13,473	50,000	250,000	14,326	1,794,141	1,687,231
$ Settlements	481,568	16,583,830	0	0	35,000	14,326	380,074	492,197
$ Damages Granted	8,311	286,772	0	0	0	14,326	27,710	6,280

Table 1

Summary Statistics – *Continued*

Variables	Mean	SD	P25	P50	P75	Obs.	Recession Advisors	Non-Recession Advisors
Table 8	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Local Recession	0.330	0.470	0	0	1	6,894,718	0.363	0.326
Table 9								
Chief Compliance Officer %								
at Top-20 Misconduct Firm	0.205	4.528	0	0	0	478,450	0.208	0.205
at Other Firm	1.238	11.056	0	0	0	478,450	1.321	1.229
Top Executive %								
at Top-20 Misconduct Firm	0.069	2.625	0	0	0	478,450	0.083	0.067
at Other Firm	1.561	12.396	0	0	0	478,450	1.627	1.554
Table 10								
Boom Advisor	0.392	0.488	0	0	1	6,894,718	0	0.445

Table 2
Professional Misconduct

This table reports the coefficient estimates of linear probability model regressions. Each observation is at the advisor-year level. *Misconduct* is an indicator variable equal to one if there is a misconduct record for an advisor in a given year. *Recession Advisor* is an indicator variable equal to one if an advisor's first job begins during a recession. Details of other variables are in Appendix A. The economic effects are computed by dividing the coefficient estimates of *Recession Advisor* by the mean of the dependent variable. The sample period is from 2007 to 2017. Standard errors clustered at the firm-level are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

	Dependent variable: *Misconduct*		
Independent variables	(1)	(2)	(3)
Recession Advisor	-0.040**	-0.089***	-0.056***
	(0.018)	(0.015)	(0.012)
Prior Misconduct			1.824***
			(0.071)
Years of Experience			0.113***
			(0.013)
Investment Adviser Exam (65/66)			0.202***
			(0.023)
Securities Agent State Law Exam (63)			0.114***
			(0.013)
General Securities Rep. Exam (7)			-0.007
			(0.037)
Invest. Company Product Rep. Exam (6)			0.015
			(0.030)
General Securities Principal Exam (24)			-0.025
			(0.020)
Number of Other Qualifications			-0.317***
			(0.078)
Firm × County × Year Fixed Effects	No	Yes	Yes
Observations	7,183,008	6,894,718	6,894,718
R-squared	0.000	0.092	0.095
Economic effect of *Recession Advisor*	-7.2%	-16.0%	-10.1%

Table 3

Hiring Firms and Advisor Quality

This table reports the coefficient estimates of linear probability model regressions. Each observation is at the advisor-year level. *Misconduct* is an indicator variable equal to one if there is a misconduct record for an advisor in a given year. *Recession Advisor* is an indicator variable equal to one if an advisor's first job begins during a recession. *Advisor Quality* is an indicator variable equal to one if an advisor has had a Series 6 or 7 license for seven or more years and is currently registered in nine or more states. *Assets under Management (Ln)* is the natural logarithm of an advisor's assets under management. *Pre-Advisor Criminal Record* is an indicator variable equal to one if there is a criminal charge before an individual becomes a financial advisor. Details of other variables are in Appendix A. The economic effects are computed by dividing the coefficient estimates of *Recession Advisor* by the mean of the dependent variable. The sample period is from 2007 to 2017. Standard errors clustered at the firm-level are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

	Dependent variable: *Misconduct*				
Independent variables	(1)	(2)	(3)	(4)	(5)
Recession Advisor	-0.041***	-0.086***	-0.068***	-0.053***	-0.057**
	(0.012)	(0.019)	(0.022)	(0.012)	(0.025)
Advisor Quality		0.137***			0.089**
		(0.031)			(0.040)
Assets under Management (Ln)			0.019***		0.015**
			(0.005)		(0.007)
Pre-Advisor Criminal Record				0.642***	0.570***
				(0.044)	(0.103)
Control variables	Identical to those in column 3 of Table 2				
Firm × County × Year Fixed Effects	Yes	Yes	Yes	Yes	Yes
Initial Placement Fixed Effects	Yes	No	No	No	Yes
Observations	6,893,767	2,529,627	1,464,832	6,894,718	1,183,177
R-squared	0.098	0.123	0.141	0.093	0.151
Economic effect of *Recession Advisor*	-7.4%	-15.0%	-10.9%	-9.5%	-6.9%

Table 4

Opportunities to Commit Misconduct

This table reports the coefficient estimates of linear probability model regressions. Each observation is at the advisor-year level. *Misconduct* is an indicator variable equal to one if there is a misconduct record for an advisor in a given year. *Recession Advisor* is an indicator variable equal to one if an advisor's first job begins during a recession. Columns 1 and 2 restrict the sample to the set of currently active financial advisors that are in client-facing roles. Columns 3 and 4 re-estimate the baseline regression for retail and non-retail firms, respectively. Columns 5 and 6 re-estimate the baseline regression for the top-20 misconduct firms and other firms, respectively. Details of other variables are in Appendix A. The economic effects are computed by dividing the coefficient estimates of *Recession Advisor* by the mean of the dependent variable. The sample period is from 2007 to 2017. Standard errors clustered at the firm-level are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

	Client-Facing Advisors					
	Definition Based on Discovery Data	Definition Based on Qureshi and Sokobin (2015)	Retail	Non-Retail	Top-20 Misconduct Firms	Non-Top-20 Misconduct Firms
	Dependent variable: *Misconduct*					
Independent variables	(1)	(2)	(3)	(4)	(5)	(6)
Recession Advisor	-0.071***	-0.079***	-0.052***	-0.057***	-0.096***	-0.049***
	(0.015)	(0.016)	(0.015)	(0.019)	(0.029)	(0.013)
Control variables	Identical to those in column 3 of Table 2					
Firm × *County* × *Year FEs*	Yes	Yes	Yes	Yes	Yes	Yes
Observations	5,288,228	2,612,199	4,993,748	1,900,970	1,001,427	5,893,291
R-squared	0.102	0.125	0.089	0.115	0.078	0.100
Economic effect of *Recession Advisor*	-10.3%	-14.2%	-9.0%	-11.4%	-11.6%	-9.6%
Compare between:			(3) vs. (4)		(5) vs. (6)	
Difference in estimates			0.005		-0.047**	
(*p*-value)			0.374		0.048	

Table 5

Alternative Samples

Panel A tabulates the number of sample advisors entering in each NBER recession or expansion period. Panel B re-estimates our baselines specifications based on alternative samples.

Panel A: Financial Advisors by NBER Recessions or Expansions

		Recession (Peak to Trough)		**Non-Recession** (This Trough to Next Peak)	
Peak Month	**Trough Month**	**# Months**	**# Advisors**	**# Months**	**# Advisors**
February 1945	October 1945	8		37	2
November 1948	October 1949	11	1	45	16
July 1953	May 1954	10	5	39	29
August 1957	April 1958	8	9	24	30
April 1960	February 1961	10	28	106	1,108
December 1969	November 1970	11	688	36	1,254
November 1973	March 1975	16	734	58	3,220
January 1980	July 1980	6	789	12	1,750
July 1981	November 1982	16	5,142	92	62,962
July 1990	March 1991	8	7,121	120	282,111
March 2001	November 2001	8	32,659	73	272,686
December 2007	June 2009	18	84,210		360,893

Panel B: Alternative Samples

	Removing Financial Advisors Who Joined Before 1992	Removing Financial Advisors Who Joined Before 1997	Removing Financial Advisors Who Joined Before 2002
	Dependent variable: *Misconduct*		
Independent variables	(1)	(2)	(3)
Recession Advisor	-0.044***	-0.032**	-0.034**
	(0.013)	(0.013)	(0.016)
Control variables	Identical to those in column 3 of Table 2		
Firm × *County* × *Year FEs*	Yes	Yes	Yes
Observations	6,084,594	5,160,638	3,585,350
R-squared	0.093	0.092	0.087
Economic effect of *Recession Advisor*	-8.6%	-6.9%	-8.5%

Table 6

Textual Analyses of Customer Complaints

This table reports the coefficient estimates of linear probability model regressions. Each observation is at the advisor-year level. *Risky Investment* is an indicator variable equal to one if there is a customer complaint about highly risky investment in a given year. *Misrepresentation* is an indicator variable equal to one if there is a customer complaint about misrepresentation in a given year. *Unauthorized Transaction* is an indicator variable equal to one if there is a customer complaint about an unauthorized transaction in a given year. *Fee or Commission* is an indicator variable equal to one if there is a customer complaint about an advisor's fee or commission in a given year. *Unsuitable* is an indicator variable equal to one if there is a customer complaint about the unsuitability of investment product in a given year. *Omission of Material Fact* is an indicator variable equal to one if there is a customer complaint about the omission of material fact in a given year. *Fraud* is an indicator variable equal to one if there is a customer complaint about fraud in a given year. *Fiduciary Duty* is an indicator variable equal to one if there is a customer complaint about fiduciary duty in a given year. *Negligence* is an indicator variable equal to one if there is a customer complaint about negligence in a given year. *Churning or Excessive Trading* is an indicator variable equal to one if there is a customer complaint about churning or excessive trading in a given year. *Other Allegations* is an indicator variable equal to one if there is a customer complaint that is not about unsuitable investment, misrepresentation, unauthorized transactions, omission of material fact, fee or commission, fraud, fiduciary duty, negligence, risky investment, and churning or excessive trading. The economic effects are computed by dividing the coefficient estimates of *Recession Advisor* by the mean of the dependent variable. Standard errors clustered at the firm-level are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

	Dependent variables:										
	Risky Investment	*Misrepresentation*	*Unauthorized Transaction*	*Fee or Commission*	*Unsuitable*	*Omission of Material Fact*	*Fraud*	*Fiduciary Duty*	*Negligence*	*Churning or Excessive Trading*	*Other Allegations*
Indep. variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Recession Advisor	-0.016***	-0.053***	-0.015***	-0.016***	-0.039***	-0.008***	-0.007***	-0.006**	-0.005*	-0.001	-0.052***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Control variables	Identical to those in column 3 of Table 2										
Fixed effects	*Firm* × *County* × *Year Fixed Effects* included										
Observations	6,894,718	6,894,718	6,894,718	6,894,718	6,894,718	6,894,718	6,894,718	6,894,718	6,894,718	6,894,718	6,894,718
R-squared	0.090	0.100	0.077	0.095	0.106	0.095	0.119	0.135	0.136	0.087	0.089
Economic effect of *Recession Advisor*	-34.0%	-26.1%	-34.0%	-28.6%	-22.3%	-12.2%	-32.4%	-13.7%	-5.8%	-1.7%	-26.9%

Table 7

Damages and Settlements

This table reports the coefficient estimates of ordinary least squares regressions. Each observation is at the advisor-year level. *Recession Advisor* is an indicator variable equal to one if an advisor's first job begins during a recession. *$ Damages Requested (Ln)* is the natural logarithm of one plus the total amount of damages requested by clients against an advisor in a given year. *$ Settlements (Ln)* is the natural logarithm of one plus the total amount of settlements between an advisor and his/her clients in a given year. *$ Damages Granted (Ln)* is the natural logarithm of one plus the total amount of damages granted to clients of an advisor after arbitration in a given year. Details of other variables are in Appendix A. Standard errors clustered at the firm-level are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

Panel A: Full Sample			
	Dependent variables:		
	$ Damages Requested (Ln)	*$ Settlements (Ln)*	*$ Damages Granted (Ln)*
Independent variable	(1)	(2)	(3)
Recession Advisor	-0.011***	-0.008***	-.0001
	(0.002)	(0.001)	(0.000)
Control variables	Identical to those in column 3 of Table 2		
Firm × County × Year Fixed Effects	Yes	Yes	Yes
Observations	6,894,718	6,894,718	6,894,718
R-squared	0.116	0.099	0.109
Panel B: Sample with Damages Requested > $0			
Recession Advisor	-0.048	-0.028	0.082
	(0.062)	(0.185)	(0.057)
Control variables	Identical to those in column 3 of Table 2		
Firm × County × Year Fixed Effects	Yes	Yes	Yes
Observations	14,326	14,326	14,326
R-squared	0.620	0.488	0.442

Table 8

Local Economic Conditions

This table reports the coefficient estimates of linear probability model regressions. Each observation is at the advisor-year level. *Misconduct* is an indicator variable equal to one if there is a misconduct record for an advisor in a given year. *Recession Advisor* is an indicator variable equal to one if an advisor's first job begins during a recession. *Local Recession* is a variable equal to one if the real growth rate in gross state product (GSP) of a state in which an advisor works is in the lower tercile across all states in a given year. Details of other variables are in Appendix A. Standard errors clustered at the firm-level are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

	Dependent variable: *Misconduct*	
Independent variables	(1)	(2)
Recession Advisor		-0.016
		(0.012)
× *Local Recession*		-0.111***
		(0.023)
Local Recession	0.134***	
	-0.026	
Control variables	Identical to those in column 3 of Table 2	
Firm × *County* × *Year Fixed Effects*	No	Yes
Firm × *County Fixed Effects*	Yes	No
Observations	6,894,718	6,894,718
R-squared	0.030	0.095

Table 9

Career Outcomes

This table reports the coefficient estimates of ordinary least squares regressions. Each observation is at the advisor level. *Recession Advisor* is an indicator variable equal to one if an advisor's first job begins during a recession. *Chief Compliance Officer at Top-20 Misconduct Firm* is an indicator variable equal to one if an advisor is the chief compliance officer of one of the top 20 firms with the advisor misconduct rates. *Chief Compliance Officer at Other Firm* is an indicator variable equal to one if an advisor is the chief compliance officer of an advisory firm that does not belong to the top 20 firms with the highest advisor misconduct rates. *Top Executive at Top-20 Misconduct Firm* is an indicator variable equal to one if an advisor is a top executive of one of the top 20 firms with the highest advisor misconduct rates. *Top Executive at Other Firm* is an indicator variable equal to one if an advisor is a top executive of an advisory firm that does not belong to the top 20 firms with the highest advisor misconduct rates. Panel A (B) is based on the full sample (those advisors who joined over 2002-2017). Standard errors are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

Pane A: Full Sample				
	Dependent variables:			
	Chief Compliance Officer at Top-20 Misconduct Firm	*Chief Compliance Officer at Other Firm*	*Top Executive at Top-20 Misconduct Firm*	*Top Executive at Other Firm*
Independent variable	(1)	(2)	(3)	(4)
Recession Advisor	0.007	0.159***	0.014	0.154**
	(0.023)	(0.055)	(0.013)	(0.061)
Initial Placement FEs	Yes	Yes	Yes	Yes
Observations	478,450	478,450	478,450	478,450
R-squared	0.035	0.075	0.030	0.114
Economic Magnitude of *Recession Advisor*	3.4%	12.8%	20.3%	9.9%
Pane B: Subsample Based on Advisors Who Joined over 2002-2017				
Recession Advisor	0.042	0.281***	0.013	0.285***
	(0.030)	(0.065)	(0.015)	(0.066)
Initial Placement FEs	Yes	Yes	Yes	Yes
Observations	280,569	280,569	280,569	280,569
R-squared	0.057	0.105	0.045	0.164
Economic Magnitude of *Recession Advisor*	22.8%	31.1%	30.4%	28.9%

Table 10

Boom Advisors

This table reports the coefficient estimates of linear probability model regressions. *Misconduct* is an indicator variable equal to one if there is a misconduct record for an advisor in a given year. *Boom Advisor* is an indicator variable equal to one if an advisor's first job begins during a boom. *Recession Advisor* is an indicator variable equal to one if an advisor's first job begins during a recession. *Local Recession* is a variable equal to one if the real growth rate in gross state product (GSP) of a state in which an advisor works is in the lower tercile across all states in a given year. Details of other variables are in Appendix A. Standard errors clustered at the firm-level are reported in parentheses. ***, **, and * indicate two-tailed *t*-statistics statistical significance at the 1%, 5%, and 10% level, respectively.

	Dependent variable: *Misconduct*	
Independent variable	(1)	(2)
Boom Advisor	0.036***	0.016*
	(0.010)	(0.009)
× *Local Recession*		0.062***
		(0.017)
Recession Advisor	-0.042***	-0.011
	(0.012)	(0.014)
× *Local Recession*		-0.085***
		(0.021)
Control variables	Identical to those in column 3 of Table 2	
Firm × *County* × *Year Fixed Effects*	Yes	Yes
Observations	6,884,091	6,884,091
R-squared	0.093	0.093