Bad Apples Keep Rolling Back to Like-Minded Firms

By Tamika Cody March 7, 2016

One might ask how it is possible that financial advisors with infractions on their record make their way back into the industry after being fired from reputable firms. One potential answer – they are being recruited into a small number of firms where the main goal is to be perpetually immoral.

Such bad apples exist in all pockets of society, and in the advice business – where the term "advisor" can apply to anyone from a family office chief executive to someone selling penny stocks – their numbers are actually relatively few. In a country where around 20% of the population has a criminal record, a new study has found that nearly 7% of advisors have misconduct records.

Mark Egan, an associate professor at the **University of Chicago**'s Booth School of Business who helped conduct a study into advisor misconduct, says his team found evidence there are firms which specialize in recruiting advisors who have the misconduct label attached to their professional file.

"These advisors are hired by firms that already employ other advisors with blemishes on their records," says Egan. "On average, the firms are smaller, less reputable and pay less." The report cited most of these advisors as making $15,000 less per year.

Starkly different in nature to mainstream wealth management firms, these boiler rooms are more akin to the shakedown operations depicted in films such as the *Wolf of Wall Street*.

According to the study, the advisors in these firms tend to prey on clients who are not financially savvy, uneducated, and wealthy retirees. Most of these firms are less likely to fire advisors who engage in misconduct again and again.

But time may be running out for firms and advisors who target unsophisticated investors, as **Finra** continues its mission to keep insubordinate advisors at bay.

In 2013, Finra launched a High Risk Broker initiative to identify individuals for targeted, expedited investigation. By 2015, Finra permanently barred close to 500 individuals and 25 firms from the industry.

"Finra keeps close tabs on potentially high-risk registered persons and the firms that hire them," says Finra's director of media relations, **Ray Pellecchia**.

The organization uses a number of methods, including sophisticated data mining analytics and near-real-time analysis of incoming tips, complaints and ongoing field examinations.

“We monitor broker migration, especially from firms with regulatory issues or those that withdraw their registration due to, among other things, regulatory scrutiny,” says Pellecchia.

Finra requires that all registered advisors reveal customer complaints, arbitrations, regulatory actions, employment terminations, bankruptcy filings and judicial proceedings.

Pellecchia added that not all disclosures indicate regulatory problems. “For example, an arbitration complaint that has been dismissed is still disclosed,” says Pellecchia. “And a single disclosure over a long career is not per se indicative of a regulatory problem.”


Mark Egan

Researchers of the study, Market for Financial Adviser Misconduct, created a database that kept tabs on 644,277 current registered advisors and 638,528 previously registered advisors in the United States between the years of 2005 to 2015; some 1.2 million individuals in total.

The study observed each advisor’s registrations, licenses, industry exams they passed, and employment history in the financial services industry, some dating back more than 10 years. The data also tracked any disclosure filed, including customer disputes, disciplinary events, as well as personal bankruptcy and other financial difficulties.

“In the year following a misconduct disclosure, 48% of advisors leave their job,” says Egan. “Forty-four percent of those advisors who leave their job after misconduct are rehired within one year – typically in the same state and in the same county. In total, 73% of advisors [with misconduct disclosures] remain active in the industry in the year following misconduct.”