Private Equity and Financial Adviser Misconduct*

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October 26, 2022

Does ownership by private equity firms encourage or deter financial misconduct? We examine this issue by analyzing the records of individual financial advisers around buyouts of investment advisory firms by private equity. Our estimates suggest that private equity ownership leads to an increase of 147% in the percentage of the acquired firm's financial advisers committing misconduct. While the misconduct rate of the acquired firms is only about 40% of the industry average before the buyout, it becomes on par with the industry average after the buyout. Within-adviser variation accounts for 89% of the increase in the adviser's misconduct probability. The increase in misconduct is stronger in firms with higher post-buyout growth in assets under management per adviser and is concentrated in firms whose clients include retail customers. Our results suggest that a heightened profit motive of advisory firms is likely to compromise the interest of financially unsophisticated advisees.

JEL codes: G11, G20, G23

Keywords Financial adviser, financial misconduct, private equity, asset management, business ethics, fraud.

*We thank Maria Chaderina, Douglas Cumming (discussant), Karim Farroukh (discussant), Stuart Gillan, Jia He (discussant), Amit Seru, and conference and seminar participants at University of Oregon, University of Northern Texas, European Financial Management Association meeting 2022, China International Conference in Finance 2022, China Risk Forum 2022, and NRS Spring 2022 Compliance Conference for helpful comments. The Securities and Exchange Commission disclaims responsibility for any private publication or statement of any SEC employee or Commissioner. This article expresses the author's views and does not necessarily reflect those of the Commission, the Commissioners, or other members of the staff. This paper was initially released prior to Sheen joining the Commission.

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1 Introduction

Financial advisers play a major role in asset management. According to the annual report of the Investment Adviser Association and National Regulatory Services (2020), there were 13,494 investment advisory firms registered with the U.S. Securities and Exchange Commission (SEC) in 2020, employing over 450 thousand individual advisers and serving 51.8 million clients. Their total regulatory assets under management amounted to $97.2 trillion. As such, the behavior of financial advisers has significant effects on financial market efficiency and household financial wellness.[1] One special concern is financial adviser misconduct. Using a comprehensive sample of financial advisers from 2007 to 2015, Egan et al. (2019) document that seven percent of financial advisers have misconduct records. Previous studies have examined various determinants of financial adviser misconduct. The objective of our paper is to extend this literature by examining the impact of private equity (PE) ownership.

PE firms have become increasingly important in the economic landscape. Statistics from Bain & Company (2021) show that the industry has raised almost $5 trillion in capital from 2016 to 2020. PE firms have also shown a keen interest in the financial advisory business in recent years. According to Huang (2019), citing internal research by M&A consultant DeVoe & Co, PE firms participated in 5% of all registered investment advisory firm merger transactions from 2013 to 2019 and accounted for 26% of the deals as measured by assets under management. An investigation of the effect of PE ownership on financial adviser misconduct is interesting for several reasons. First, PE firms are known for their strong focus on profit maximization. Does a strong profit motive mitigate or exacerbate the problem of misconduct? On the one hand, maintaining a clean record may help an advisory firm attract more customers, boosting profits. On the other hand, a strong profit motive may push employees to aggressively seek every profit opportunity, compromising the control for misconduct. Ultimately, if we assume PE is good at maximizing profit, whether PE ownership encourages or deter misconduct depends on its cost-benefit trade-off, and the resulting effect on misconduct is an empirical question. Second, while previous studies have shown that PE ownership leads to better operational practices in many aspects, in markets with opaque product quality, the PE buyout effect is controversial.[2] The product and service quality offered by financial

[1] See, for example, the study of Foerster et al. (2017) using Canadian household data.

[2] In the healthcare industry, existing literature documents both worse operational outcomes(Gupta et al. (2021))

advisers are difficult for many customers to discern. It remains unclear whether PE buyouts in this industry lead to better or worse conduct of investment advisers.

To examine the effect of PE ownership on financial adviser misconduct, we collect from Pitchbook all PE-backed buyout deals in which the target is a US-headquartered financial advisory firm. We match the target firms of these deals to the universe of SEC-registered investment advisory firms, compiled using the annual Form ADV filings of these firms. We further collect records of individual advisers from the SEC Investment Adviser Public Disclosure (IAPD) website. By matching the individual adviser data with the firm level data using the employer's CRD (Central Registration Depository) number, we construct an adviser-year panel data set that includes each adviser's employment history, qualifications, and incidents of misconduct, as well as employer-related variables and an indicator variable for PE acquisition treatment. Altogether, we have a sample of 540,370 individual advisers matched to 14,383 advisory firms registered with the SEC from 2000 to 2020. We identify 275 PE-backed buyout deals in which the target firms filed at least one ADV form during our sample period. 173 target firms have their ADV filings as well as the individual adviser records in the year before the buyout, among which 57 also have firm- and adviser-level data for at least one post-buyout year.

Identifying the PE buyout effect is complicated by the endogenous selection of buyout targets by PE firms. To better understand the interaction between PE buyout and financial adviser misconduct, we first test for a selection effect. Using the measures of misconduct as a predictor of the buyout deal, we find a negative relation between the lagged misconduct measures and the probability of acquisition by PE firms. Further analysis using individual misconduct type shows that civil, criminal, and regulatory misconduct rates as well as misconduct-related job terminations are red flags that significantly reduce the probability of a PE buyout. Customer disputes, however, do not have a significant impact.

We then test the PE buyout effect on misconduct measured at both the adviser and firm levels. To reduce selection bias, we construct a control group containing up to four closest matches for each acquired firm, including matching on pre-treatment misconduct rate. These five firms form a cohort. We run stacked difference-in-difference regressions controlling for $Firm \times Cohort$ and $Time \times Cohort$ fixed effects, which ensures that we exploit only within-firm variation and that our estimates are

and improved operational efficiency(Gao et al. (2021)) brought about by PE.

not affected by unobservable differences between the acquired and the control firms (as long as the unobservables are time-invariant within a cohort). We find a sharp increase in misconduct after PE takeovers both for individual advisers and advisory firms. At the adviser level, the estimated treatment effects of PE buyouts on misconduct probability and the misconduct incident count are, respectively, 32% and 50% of the unconditional means of these variables. Further analysis controlling for adviser fixed effects suggest that 89% of the increase in misconduct probability and 50% of the increase in the misconduct incident count are due to behavioral changes of advisers who have worked in the acquired firm both before and after the buyout.

The firm-level results are even more striking. Our estimates suggest that private equity ownership leads to an increase of 147% in the percentage of the acquired firm's financial advisers committing misconduct and an increase of 200% in the average per adviser misconduct incident count. As a result, while the misconduct rate and per adviser misconduct incident count of the acquired firms are only about 40% of the corresponding industry means before the buyout, they become on par with the industry averages after the buyout. The misconduct types that drive the results most are regulatory conduct and customer disputes.

Overall, our findings indicate that PE chooses cleaner firms in terms of misconduct as buyout targets. After PE takeover, however, firms commit more misconduct. These results suggest implications about the value of misconduct. If we assume PE maximizes firm value, the increased level of misconduct implies that higher misconduct is related to higher profit. PE firms choose targets with untapped "misconduct slack" and exploit this opportunity to make profit, perhaps at the expense of customers. Consistent with this interpretation, we find that the increase in misconduct is more significant in firms experiencing faster post-buyout growth in assets under management per adviser, and it is concentrated in firms whose clients include retail customers. The acquiring firms' lack of experience and expertise in the advisory business may have also contributed to the increase in misconduct, because the increase is not observed in PE-backed management buyout deals, nor in deals led by PE firms with a focus on industries related to financial advising.

Our paper is closely related to two recent studies by Dimmock et al. (2018) and Tookes and Yimfor (2021), who both examine the changes in financial adviser misconduct following advisory firm mergers. However, the focus of these studies are very different from ours. The objective of Dimmock et al. (2018) is to identify coworkers' effect on misconduct using changes in coworkers at

the branch level caused by mergers of financial advisory firms. They find that the probability of an advisor committing misconduct increases if his new coworkers have a history of misconduct. Tookes and Yimfor (2021) find that following mergers, new disclosures of employee misconduct in the combined advisory firm drop by 25 to 34 percent, and the sensitivity of employment separation to misconduct increases. These findings suggest stronger post-merger disciplinary mechanisms against misconduct. Unlike these studies, we focus specifically on the role of private equity ownership. Furthermore, unlike in the case of a firm merger, which combines two firms into one, the firms in our sample remain as separate Form ADV filing entities after the ownership change, which allows us to explore within-firm variation.

Our study contributes to a fast-growing literature on misconduct and conflicts of interest in financial advisory services. One strand of this literature analyzes and documents the distorted incentives of financial advisers. Theoretically, Stoughton et al. (2011) and Inderst and Ottaviani (2012) show how kickbacks distort the incentive of financial advisers, especially when customers are unsophisticated. Empirically, Zitzewitz (2006), Bollen and Pool (2012), and Dimmock and Gerken (2012) develop methods to detect and predict investment adviser frauds. Christoffersen et al. (2013), Egan (2019) and Egan et al. (2021a) show that brokers distort household investment decisions toward inferior investment products that allow them to earn higher commissions. Egan et al. (2019) find large and persistent differences in the degree of misconduct across both firms and individual advisers. Chalmers and Reuter (2020) find that replacing broker advice by default investing in target date funds leads to better investment performance for advice-dependent investors.[3] Another strand of this literature examines the determinants of financial advisers misconduct. Charoenwong et al. (2019) find that the level of misconduct of midsize investment advisory firms increases relative to other groups after the Dodd-Frank Act shifted regulatory jurisdiction over these firms from the SEC to state regulators, suggesting weaker monitoring by the latter. Gurun et al. (2021) find that financial advisers' ability to maintain client relationships as they move weaken their employers' willingness to fire advisers for misconduct, which leads to an increase in the level of misconduct. Egan et al. (2019) show that labor markets partially undo the firm-level discipline of advisers with

[3]As an alternative explanation for the poor performance of financial advisers, Linnainmaa et al. (2021) show that it is the misguided believes of the financial advisers instead of the conflicts of interests that contribute to the inferior financial advice. Chang and Szydlowski (2020) show in a matching model with two-sided heterogeneity that lower returns earned by advised investors relative to the self-directed investors does not mean advice destroys value. Instead it is due to a selection effect because more informed investors do not use advisers.

misconduct by rehiring them. Egan et al. (2021b) find that following an incident of misconduct, labor market penalties for female advisers are higher than for male advisers. Dimmock et al. (2021) find that when a financial adviser has a negative personal financial shock due to real estate price changes, the adviser is more likely to commit misconduct. Our study extends this literature by showing the effect of PE ownership on financial misconduct.

We also contribute to the growing literature on the effects of PE investment on firm operations. Many studies have documented positive real effects of PE ownership, including increased total factor productivity (Davis et al. (2014)) and employee safety (Cohn et al. (2021)), improved managerial and operational practices (Bloom et al. (2015), Bernstein and Sheen (2016)), reduced agency problems (Edgerton (2012)), faster sales growth (Boucly et al. (2011), Fracassi et al. (2021)), and stronger resilience during the financial crisis (Bernstein et al. (2018)). But in markets with opaque product quality and stricter regulation, like higher education and healthcare, PE buyout effects are controversial. Eaton et al. (2020) document worse outcomes after PE buyout in higher education. In healthcare, Gupta et al. (2021) and Gao et al. (2021) give opposite results indicating the complicated effect on this highly regulated industry. Similarly, the effect of PE on long-run activity, such as investments in innovation, is less clear. For example, Lerner et al. (2011) find a positive PE effect on firm innovation, while Cumming et al. (2020) find the opposite. To our knowledge, this is the first study to investigate the PE buyout effect in the financial advisory industry.

The remaining part of the paper is structured as follows. We discuss potential effects of PE on financial misconduct and describe our empirical approach in Section 2, present the data and summary statistics in Section 3, and show the main results in Section 4. We explore the mechanisms that drive the results in Section 5 and conclude in Section 6.

2 Hypotheses and Empirical Strategy

2.1 Possible Effects of PE Ownership on Misconduct

Why might the PE takeover of an investment advisory firm result in a change to the intensity of investment advisor misconduct? The role of misconduct in the advisory industry and the incentives and strategies of PE firms interact to create a rich set of hypotheses. The key open question is whether and when misconduct is a positive NPV activity for the advisory firm, notwithstanding the unambiguous negative impact on the customer stakeholder. Less misconduct is more desirable

for potential advisees, but misconduct may bring benefits such as higher fees to the advisory firm.

As noted in Introduction, previous studies have documented various positive real effects of PE ownership, which suggests that the profit motive of PE leads to improved conditions for other stakeholders as well. The same logic implies that it could also lead to less misconduct, because misconduct can lower profitability by reducing the reputation of the advisory firm. For example, Di Maggio et al. (2021) find that investors are less likely to trade with those that have engaged in misconduct in the past, suggesting a certain degree of product market discipline. Gurun et al. (2017) find that residents of communities that were exposed to the Madoff Ponzi scheme scandal subsequently withdrew assets from investment advisers, supporting the importance of reputation and trust in the investment advisory industry. Misconduct also generates direct costs through fines and judgements borne by the firm. Previous studies have also show that PE ownership is associated with superior people management practices and monitoring practices (Bloom et al. (2015) and Bernstein and Sheen (2016)). PE's superior operational controls, together its strong reputational concerns, can help to prevent advisers from committing misconduct.

PE takeovers could also lead to increased misconduct. For many industries, what's good for the customer is often best for the firm. A cheap product, efficiently produced with high quality may lead to higher value creation. In opaque, hard-to-understand industries where customers are not playing a repeated game, however, businesses might optimally exploit customers, and the impact of PE has been found to be mixed or negative. For example, Eaton et al. (2020) document lower student graduation rates from for-profit colleges after PE buyout. In healthcare, Gupta et al. (2021) find a positive effect of PE on hospital patients, while Gao et al. (2021) find PE buyouts lead to worse outcomes for nursing home residents. A university degree or nursing home stay are complicated products that are often only purchased once. Financial advice is an opaque, complicated product for many that is purchased infrequently, and thus perhaps there is scope to take advantage of customers. The increase to firm profits by charging extra fees or placing clients in inappropriately expensive financial products may outweigh the costs of occasional violations and their associated penalties. The incentive to pursue business growth and short-term profit may be particularly strong for PE firms, because they typically resell their acquisition targets within three to seven years. Employees may also feel increased pressure to perform under PE ownership. Gornall et al. (2021) and Lambert et al. (2021) document higher levels of employee job dissatisfaction and insecurity after buyouts.

This may lead advisers to engage in misconduct to meet sales goals. Furthermore, PE buyouts may also lead to more violations of regulatory rules due to the acquiring PE firms' lack of experience and expertise in the advisory business. Ultimately, whether PE ownership exacerbates or mitigates the problem of financial advisor misconduct is an empirical question.

A related question is how misconduct records affect the PE buyout probability. Here there are two opposite predictions as well. On the one hand, PE may target firms with severe misconduct problems and create value by fixing the problems and thereby improving profitability. On the other hand, they may prefer to acquire firms with a clean record and good business ethics, which provide a better platform for future operations. Furthermore, such firms may be running business too conservatively from the profit-maximization perspective, which gives PE more "misconduct slack," allowing the target firm to remain "normal" even if its misconduct intensity increases after the buyout. Which of these two predictions is closer to reality is again an empirical question.

2.2 Empirical Strategy

We are interested in identifying the PE buyout effect on financial advisers' misconduct. However, as mentioned above, there is a potential selection effect that arises from PE acquirers' choice of buyout targets. We use different strategies to identify the the selection effect and the treatment effect.

2.2.1 Misconduct and Probability of PE buyout

The firms that PE decides to acquire may be different from the rest of the advisory firms in both misconduct and other characteristics. To provide insight into what PE looks for as well as guidance into how control firms should be selected, we estimate a linear probability model to examine the determinants of a firm's probability of being acquired by PE. In particular, we are interested in testing whether this probability is affected by a firm's misconduct record. Specifically, we adopt the following model specification:

$$Treated_{i,t} = \beta_0 + \sum_{k=1}^{3} \beta_k \overline{D}(Misconduct)_{i,t-k} + \lambda X_{i,t-1} + \delta_t + \varepsilon_{i,t} \tag{1}$$

where $Treated_{i,t}$ is an indicator variable denoting firm i being acquired by PE during year t; $\overline{D}(Misconduct)_{i,t-k}$ is firm i's misconduct rate in year $t-k$, defined as the fraction of advisers

with any misconduct that year; $X_{i,t-1}$ is a set of control variables. We use $Year$ fixed effects to remove time-varying factors like the increasing trend of PE acquisition in this industry. The coefficient β_k captures how the firm's misconduct record in year $t-k$ affects its probability of being acquired in year t. In the style of the survival analysis, once a firm is bought out by PE, we drop its subsequent observations from the sample. In other words, we only consider the first PE buyout deal of each firm.

We also consider $\overline{N}(Misconduct)_{i,t-k}$ as an alternative measure of a firm's misconduct record, which is the average number of misconduct incidents across all advisers of firm i in year $t-k$. We further disaggregate $\overline{D}(Misconduct)_{i,t-k}$ by misconduct type to examine the effect of each violation type on PE acquisition probability.

2.2.2 Effect of PE Buyout on Misconduct

To estimate the PE buyout effect on financial adviser misconduct, one challenge is to find a reasonable counterfactual for firms acquired by PE. Simply comparing the treated firms with the industry average could generate bias since firms acquired by PE may be fundamentally different from the rest of the industry. Therefore, following Gormley and Matsa (2011), we build a control group of comparable firms for each PE-acquired firm and run stacked difference-in-difference (DiD) regressions to investigate the PE buyout effect on misconduct. Recent studies in econometrics have shown that the standard staggered DiD design (i.e., the estimation of a two-way fixed effects model using panel data) generates biased estimates in the setting with staggered timing of treatment assignment and treatment effect heterogeneity.[4] Baker et al. (2021) review the alternative estimators proposed in the literature and find that stacked DiD estimator is able to identify the true treatment effects.

To implement the stacked DiD analysis, we choose an event window of ten years, from year $t-4$ to year $t+5$, where year t is the buyout year. We require each treated firm and each control firm to have data available at least in year $t-1$ and $t+1$. For each treated firm satisfying such a requirement, we identify up to four closest matches as its control group. The control firms must be located in the same state as the treated firm, with a similar misconduct record and a similar size of assets under management in the year before the buyout.[5] Such a control-treatment group

[4] See, for example, Sun and Abraham (2021).

[5] Specifically, we first exclude all the firms that were ever acquired by PE from the control set. Then, for all the possible controls matched by a treated firm's state and year, we exclude those whose average misconduct rates in the three years before the buyout year (t-3 to t-1) differ from that of the treated firm by 5 percentage points. We then

is called a cohort. An implicit assumption is that firms in the same cohort would follow a similar trend in the absence of the treatment; therefore, the control firms in the cohort can be used as a counterfactual for the treated firm. We stack observations in all cohorts to conduct the DiD regressions. We conduct analysis at both the firm and the adviser levels.

First, we use the following linear specification to test the PE buyout effect on misconduct measured at the individual adviser level:

$$y_{j,i,c,t} = \beta_0 + \beta_1 Treated_{i,c} \times Post_{c,t} + \gamma X_{j,i,c,t} + \delta_{t,c} + \theta_{i,c} + \varepsilon_{i,j,c,t} \tag{2}$$

where $y_{j,i,c,t}$ is the misconduct measure for adviser j in firm i and cohort c during year t. We use $D(Misconduct)$, $N(Misconduct)$ and indicator variables for five individual types of misconduct as the dependent variable. $Treated_{i,c}$ is a dummy variable indicating whether firm i in cohort c belongs to the treatment group or the control group. $Post_{c,t}$ is a dummy variable indicating whether year t in cohort c is in the post-treatment period. β_1 is the coefficient we are interested in, which detects the treatment effect measured at the individual adviser level. In the control variable set X, we include the logarithm of a financial adviser's years of experiences in the industry and the qualification exams she passed. The $Firm \times Cohort$ fixed effect term $\theta_{i,c}$ removes the cohort-specific firm fixed effects and the $Time \times Cohort$ fixed effect term $\delta_{t,c}$ removes the cohort-specific time fixed effects. These fixed effects greatly alleviate the select bias concern since our identification exploits only within-firm and within-year variation in each treatment-control group. In particular, our approach overcomes a key concern due to acquirers' endogenous choice of buyout targets, i.e., unobservable differences between the treated firms and the controls, as long as those differences are invariant within the time window. In our benchmark specification (2), we do not include $Adviser \times Cohort$ fixed effects, because the treatment effects are not limited to the effect on the same financial adviser. They can also be due to a composition effect. In other words, the firm's misconduct intensity can change due to departures of existing financial advisers or arrivals of new advisers. We consider $Adviser \times Cohort$ fixed effects in Section 5 when we examine the mechanisms of the PE buyout effect.

choose two closest matches from the set of firms larger than the treated firm and two from the set of firms smaller than the treated, measured by AUM in year t-1. Finally, a control firm selected based on the procedures above is excluded if the size difference between the control and the treated is larger than 50% of the total size of the two firms.

Then, we use the following specification to test the buyout effect on misconduct measured at the firm level:

$$y_{i,c,t} = \beta_0 + \beta_1 Treated_{i,c} \times Post_{c,t} + \gamma X_{i,c,t} + \delta_{t,c} + \theta_{i,c} + \varepsilon_{i,c,t} \tag{3}$$

where $y_{i,c,t}$ is the misconduct measure for firm i in cohort c during time t. We use both $\overline{D}(Misconduct)$ and $\overline{N}(Misconduct)$ as the dependent variable. We also use the misconduct rate measured by each misconduct type separately as the dependent variable to pin down the effect on each type of misconduct. $Treated_{i,c}$ is a dummy variable indicating whether firm i in cohort c belongs to the treatment group. $Post_{c,t}$ is a dummy variable indicating whether year t in cohort c belongs to the post-measurement period. β_1 is the coefficient we are interested in, which captures the treatment effect. The control variables in $X_{i,c,t}$ include the time-varying measures of firm size: $ln(AUM)$ and $ln(1+Nadv)$. As in model (2), we also control for $Firm \times Cohort$ fixed effects and $Time \times Cohort$ fixed effects in Eq. (3). Since the misconduct rate and average misconduct incident count are measured more accurately when the number of advisers is larger, we weight each observation in the firm-level analysis by the number of advisers in the firm.

3 Data and Descriptive Statistics

There are three main data sources utilized in this study. In this section, we discuss how we match them and construct the adviser-level and firm-level data used in our analysis. Table A.1 describes the details of our variable definitions.

3.1 Data Sources

3.1.1 Individual Financial Adviser Data

Our individual adviser data comes from the IAPD reports available from the SEC Investment Adviser Public Disclosure (IAPD) Website (https://adviserinfo.sec.gov/). Financial advisers in this study specifically refers to individuals who are registered as investment advisers at least for some period in their employment histories. Investment advisers are required to file Form U4 when first registered, and file an update following any material changes.

Each financial adviser is identified by a unique CRD number, which remains the same for the

financial adviser's entire employment history. There is a PDF-formatted report for each CRD. We download all the reports and construct adviser-year panel data by parsing through the reports. The information extracted includes employment history (registered employment exclusively), qualification exams, and misconduct disclosures. We link each adviser-year observation to only one employer. If an individual simultaneously works for multiple firms or switches jobs in the middle of year, we keep the employer that the individual is affiliated with for the longest time and prioritize the employers for whom the individual works as an investment adviser (as opposed to a broker). The sample period for the adviser-year panel data is from fiscal years 2000 to 2020.

Our individual adviser database overlaps with the financial adviser database used in Egan et al. (2019) and Egan et al. (2021b), which covers the period from 2005 to 2015, but with one important difference. While we focus on investment advisors in the SEC's IAPD database, they compile data from Financial Industry Regulatory Authority's (FINRA) BrokerCheck database, which covers all FINRA-registered brokers. Both investment advisers and brokers are broadly referred to as financial advisers, but they perform different job functions and have different legal responsibilities. Notably, brokers are regulated by FINRA and are held to a suitability standard and investment advisers are regulated by the SEC and are held to a fiduciary standard. The two databases overlap because the majority of investment advisers are dual-registered with as brokers. We use the broader term "financial adviser" to refer to individuals in our sample because those individuals may not always work as an investment adviser during our sample period.[6]

3.1.2 Investment Advisory Firm Data

Employers of financial advisers include SEC-registered investment advisory firms, states-registered investment advisory firms, and brokerage firms. We focus on the SEC-registered advisory firms for which we have most complete historical data. Advisory firms that have $100 million or more regulatory assets under management are required to register with the SEC.

Data for SEC-registered advisory firms is obtained from Part 1A of SEC ADV form. The SEC makes all the records filed since 2001 available at https://www.sec.gov/foia/docs/form-adv-archive-data.htm, covering fiscal years 2000 and onward. Firms are identified by a CRD number, which

[6]Technically, individual investment advisers working in an advisory firm are called investment adviser representatives, and the advisory firm employing them is called an investment adviser. To avoid confusion, we always call the individuals advisers and call the firm employing them an investment advisory firm or an advisory firm.

remains the same even if a firm changes its name. Firms with different CRDs can share a common parent company. Following Egan et al. (2019), we treat each CRD number as a unique firm instead of merging the subsidiaries because different CRD numbers often reflect different operations and business lines. All the investment advisory firms registered with SEC are required to electronically submit an ADV form annually or when information needs to be updated. We keep the annual updating filings from fiscal year 2000 to 2020 and construct firm-year panel data. The information we extract from the ADV form includes regulatory assets under management (AUM), number of customers, service types, compensation structure, and business practices with conflict of interest concerns. We link firm-year records with adviser-year data through firms' CRD numbers listed in each financial adviser's employment history. About 94% of individual financial advisers' are matched to the firm-level data.

3.1.3 PE-backed Acquisition Deal Data

The PE-backed merger and acquisition events are collected from the Pitchbook database. We begin by searching for all PE-backed buyout deals in which the target is in the financial advisory industry (including Asset Management, Brokerage, Investment Bank, and Consumer Finance) and headquartered in the US. We only consider deals that were completed and classified as buyout deals, including deals made by PE firms or PE-backed advisory firms. The latter are referred to as add-on deals.

To match the deals with the firms in our data sample, we first fuzzy match the target firms' names in the Pitchbook database with firm names in Form ADV filings. Then, we manually check the accuracy of matches through internet searches. If an acquired firm has multiple subsidiaries with different CRD numbers, we include all subsidiaries as the target firms of the buyout deal.

3.2 Misconduct Measurement

There are nine types of events disclosed in the IAPD report for registered advisers, but not all of them are clear indications of misconduct. For example, some may be related to an adviser's personal financial situation (for example, a personal bankruptcy). Considering the relevance to financial advisory service and following Egan et al. (2019), we focus on five types of disclosed events: civil event, criminal event, regulatory event, customer dispute, and termination.[7] A detailed description

[7]The other four types of events are Bond, Judgment/Lien, Financial, and Investigation.

of these five types of disclosed events is in Table A.2. We parse through each financial adviser's event disclosures and assign each event record to the year the disclosed event was initiated. The same disclosure event may be reported to IAPD by multiple sources, including advisers, firms, and regulators, with largely identical contents. We avoid duplicates by keeping only one report for each event.

A disclosed event, even in the five categories above, does not necessarily mean that an adviser commits any wrongdoing. To be conservative, we only consider the events in which the final resolution indicates a wrongdoing of the financial adviser, again following Egan et al. (2019). We call such cases the "confirmed cases." All termination cases are counted as confirmed cases. For civil, criminal, regulatory and customer dispute events, we first check the case status and exclude all the pending ones. We then remove the cases in which the final resolution is in favor of the advisers. For example, the cases that were dismissed, withdrawn, or denied. Table A.2 provides more details about how we identify confirmed cases.

For individual-level data, we construct a dummy variable, D(Misconduct), for each adviser-year observation which equals one if the adviser commits any type of misconduct in the year. We also construct a dummy variable for each type of misconduct, which equals one if the adviser has one or more incidents of this type of misconduct in the year. We also count the total number of misconduct incidents for each adviser in each year, denoted as N(Misconduct).

We measure the firm-level misconduct rate, $\overline{D}(Misconduct)_{i,t}$, as the percentage of advisers working in firm i committing any misconduct during year t:

$$\overline{D}(Misconduct)_{i,t} = \frac{\sum_{j=1}^{Nadv_{i,t}} D(Misconduct_{j,i,t})}{Nadv_{i,t}} \tag{4}$$

where $D(Misconduct)_{j,i,t}$ is dummy variable D(Misconduct) for adviser j working at firm i during time t and $Nadv_{i,t}$ is the total number of advisers in firm i during year t. Similarly, we construct the firm level misconduct rate for each misconduct type, $\overline{D}(Civil)_{i,t}$, $\overline{D}(Criminal)_{i,t}$, $\overline{D}(Regulatory)_{i,t}$, $\overline{D}(Customer)_{i,t}$ and $\overline{D}(Termination)_{i,t}$.

We also calculate the average misconduct incident count at the firm level as:

$$\overline{N}(Misconduct)_{i,t} = \frac{\sum_{j=1}^{Nadv_i} N(Misconduct)_{j,i,t}}{Nadv_{i,t}}. \tag{5}$$

3.3 Summary statistics

3.3.1 Individual Financial Adviser Level Summary Statistics

Summary statistics for the individual financial adviser panel are displayed in Table 1. There are 540,370 advisers (out of the universe of 572,867 advisers in the IAPD database) matched to the ADV filing advisory firm database from 2000 to 2020. Among them 337,302 are still in the sample in 2020. The average financial adviser has 12 years of experience, defined as the number of years since the adviser first registered. For the qualification exams, we keep the three most important ones: Series 63 (Uniform Securities Agent State Law Exam), which qualifies candidates as security agents; Series 65 ((Uniform Investment Adviser Law Exam), which qualifies candidates as investment advisers; and Series 66 (Uniform Combined State Law Exam), which qualifies candidates as both securities agents and investment advisers. Across the adviser-years, most advisers (76.5%) hold a qualification needed for being an investment adviser (Series 65/66) and half (49.8%) hold a broker-only qualification (Series 63).

Considering our five main categories of misconduct, the unconditional probability for a financial adviser to commit any misconduct in a given year is 0.711%, which is 19% higher than the 0.60% annual misconduct rate reported by Egan et al. (2019). This is not surprising given our focus on investment advisers instead of brokers.[8] The average misconduct incident count for a financial adviser in a given year is 0.008, thus a firm with 125 financial advisers is expected to have one incident of adviser misconduct in a year. Among the five types of misconduct, customer disputes are most common, occurring with an unconditional probability of 0.458%.

3.3.2 Firm Level Summary Statistics

Summary statistics for the firm level panel data are displayed in Table 2. In total, there are 14,383 SEC-registered financial advisory firms matched to the individual adviser database, generating 118,277 firm-year observations. The average AUM is $4,289 million (measured in year 2020 dollars), and the average number of financial advisers covered in our adviser sample is 46. Both variables are very right skewed, indicating several big firms with significant shares of the industry. The unconditional mean of the firm-level misconduct rate, $\overline{D}(Misconduct)$, is 0.454%, suggesting that

[8] Egan et al. (2019) show that investment advisers tend to have a higher misconduct rate than brokers, a finding confirmed by our sample as well.

about half a percent of an average firm's advisers commit some misconduct in a given year. The average number of per adviser misconduct incidents, $\overline{N}(Misconduct)$, is 0.005.

3.3.3 Buyout Deals

As of the end of 2020, we identify 275 PE-backed buyout deals in which the target firms filed at least one Form ADV report between 2001 and 2020. For 173 target firms, we have their data in the year before they were acquired. For our DiD analysis, which requires a firm to have at least one year of data both before and after the deal. 57 firms meet this requirement. One reason that many target firms fail to meet this requirement is that many deals are quite recent and thus post-deal observations are missing. Firms are also often merged into another firm after add-on deals, or they no longer need to file ADV forms due to changes in firm characteristics. Figure 1 shows that PE-backed deals have been steadily increasing in recent years. In particular, deals in 2020 are almost double those in 2019, indicating PE's increased interest in this industry.

4 The Relation between PE Buyout and Adviser Misconduct

In this section, we demonstrate our two main findings. First, we show that there is a negative relation between a firm's pre-treatment misconduct intensity and its likelihood of being acquired by PE. Second, we show that there is a sharp increase in misconduct after PE takeovers using stacked DiD analysis.

4.1 Misconduct and Probability of Being Acquired by PE

When PE acquirers make the decision whether to acquire a firm or not, it is reasonable to expect they would conduct due diligence about misconduct since the misconduct disclosures are public data and it is an important aspect of financial advisory firms' performance. Thus there is potentially a relation between firms' misconduct and its probability of being acquired by PE.

The regression results for Eq.(1) are displayed in Table 3. The results indicate that there exists a negative relation between the pre-treatment misconduct intensity and the probability of being acquired by PE. The coefficients on $\overline{D}(Misconduct)_{-1}$, $\overline{D}(Misconduct)_{-2}$, $\overline{N}(Misconduct)_{-1}$, and $\overline{N}(Misconduct)_{-2}$ are significantly negative, with or without controlling for firm size and growth. This suggests that PE has a preference for advisory firms with a relatively clean record as buyout targets. The coefficient estimates in column (4) imply that if a firm's average number of misconduct

incidents per adviser increases by one standard deviation (0.065) in years $t-1$ and $t-2$, the probability of a PE-backed buyout in year t decreases by 0.020 percentage points. Since the unconditional probability of an advisory firm being bought out by PE in a given year is 0.19% (based on the observations that enter the model estimation), this represents a 11% decline from the unconditional mean. Columns 2 and 4 show that PE prefers larger firms with higher AUM and more advisers. Furthermore, the coefficient on the lagged AUM growth rate is negative at the 10% significance level, suggesting that PE tends to acquire firms with a relatively slow growth rate, perhaps because it sees more room operational changes and expansions in such firms.

Table 4 demonstrates the results separately for each type of misconduct. It shows that financial adviser misconduct rates in all misconduct types other than customer disputes negatively predict PE buyouts. This suggests that while PE views civil, criminal, and regulatory misconduct, as well as misconduct-related job terminations, as red flags when choosing a buyout target, it does not pay much attention to the potential target firm's record on customer disputes.

4.2 PE Effect on Misconduct

The previous set of results shows that advisory firms with a poor misconduct record are less likely to be targets of PE buyout, which suggests a selection effect that needs to be properly accounted for in the estimation of the PE treatment effect on adviser misconduct. Our stacked DID approach is designed to address this concern. The underlying identification assumption is parallel trends for the treated and control firms in the absence of the buyout. This assumption is more likely to hold if the treated and control firms are fundamentally similar. In support of this assumption, Table 5 shows no significant difference at the conventional 5% level in any variable between the treated and control groups in the year before the treatment. Notably, compared to the full sample summary statistics in Table 2, both groups show a substantially lower misconduct rate and per adviser misconduct count. Specifically, the pre-treatment misconduct rate and per adviser misconduct count of the target firms are only about 40% of their corresponding industry averages (0.189 vs. 0.454 and 0.002 vs. 0.005, respectively).

4.2.1 Adviser level Analysis

Table 6 shows our estimates of the PE effect on financial misconduct using individual financial adviser data based on Eq. (2). The results show that PE takeovers significantly increase misconduct

of individual financial advisers. Columns 1 and 3 show the results when we only control for $Firm \times Cohort$ and $Year \times Cohort$ fixed effects, but the results are almost identical after we further control for an adviser's experience and qualifications. After a PE buyout of an advisory firm, the probability that an adviser in the treated firm commits misconduct in a given year increases by 0.23 percentage points more relative to the advisers in control firms. Given that the unconditional mean of the adviser-level misconduct rate is 0.711 per year for the full sample, this estimate of the treatment effect represents an increase of 32% from the mean, which is economically large in magnitude. In terms of the number of misconduct incidents, the estimated PE treatment effect is an increase of 0.004 events per year. This is 50% of the unconditional sample mean of the annual misconduct incident count at the adviser level, which again indicates an economically large magnitude. Columns 2 and 4 show that the advisers who hold the investment adviser qualification (Series 65/65) are more likely to commit misconduct and have more misconduct incidents. Advisers with longer experiences in the industry also tend to commit more misconduct. These results are consistent with the finding of Egan et al. (2019).

We delve deeper into the effects on specific types of misconduct. The results in Table 7 show that the increased likelihood for financial advisers committing misconduct after a PE takeover is mainly driven by increased customer disputes and regulatory misconduct. From summary statistics in Table 1, these two are the most common types of misconduct unconditionally. Civil and criminal misconduct cases are likely to be more severe and take a longer time to reach the final resolution.

4.2.2 Firm level Analysis

Table 8 shows our estimates of the PE effect on misconduct measured at the firm level based on Eq. (3). In columns 1 and 3, we control only for fixed effects; in columns 2 and 4, we further control for firm asset size and number of advisers. The estimates are very similar with or without the additional controls. Column 2 shows that after being acquired by a PE firm, the increase in the target firms' adviser misconduct rate ($\overline{D}(Misconduct)$) in the post-buyout period is 0.277 percentage points higher than the corresponding change in the control firms. Column 4 shows that the post-buyout increase in the average number of misconduct incidents per adviser ($\overline{N}(Misconduct)$) in the treated firm is 0.004 units higher than the corresponding change in the control firms. These estimates are consistent with the results at the individual adviser level. Compared with the pre-treatment levels

of misconduct rate $\overline{D}(Misconduct)$ and misconduct incident count $\overline{N}(Misconduct)$ in the treated group, 0.189% and 0.002, respectively, our estimates suggest that that misconduct rate increases by 147% and the average number of misconduct incidents increase by 200% after PE takeovers. Interestingly, by adding the estimated treatment effects to pre-buyout means, both the average misconduct rate and the average per adviser misconduct incident count in the treated firms become on par with their full sample means (0.454% and 0.005, respectively). This suggests that while PE targets advisory firms with a cleaner-than-average misconduct record, the misconduct intensity in those firms converges to the industry average after the acquisition.

Table 9 shows the results for all the five types of misconduct. Consistent with individual-level analysis, customer dispute and regulatory misconduct increase significantly after PE takeovers, while other types do not show a significant treatment effect.

4.3 Pre-trends and treatment effect dynamics

The underlying identification assumption for the DiD analysis is parallel trends of the treated and control in the absence of the treatment. To assess the plausibility of this assumption, and to examine the treatment effect dynamics, we modify Eq. (2) to allow a time-varying treatment effect in the adviser level analysis:

$$y_{j,i,c,t} = \beta_0 + \Sigma_{t=-3}^{t=5}\beta_{1,t} Treated_{j,i,c} \times P_{t,c} + \delta_{t,c} + \theta_{i,c} + \varepsilon_{j,i,c,t}, \tag{6}$$

where $P_{t,c}$ is a dummy variable indicating an event time t, where $t = -3, -2, ..., +5$, and the coefficient $\beta_{1,t}$ captures the difference between the treated firms and the control firms in period t (the base period is $t-4$).

Similarly, for the firm level analysis, we modify Eq (3) as follows:

$$y_{i,c,t} = \beta_0 + \Sigma_{t=-3}^{t=5}\beta_{1,t} Treated_{i,c} \times P_{t,c} + \delta_{t,c} + \theta_{i,c} + \varepsilon_{i,c,t}. \tag{7}$$

As with Eq. (3), we estimate this model using weighted regressions, in which each observation is weighted by the number of advisers in the firm.

Figure 2 plots the coefficients $\beta_{1,t}$ in Eq. (6), using $D(Misconduct)$ or $N(Misconduct)$ as the dependent variable. From the graph, we can see for both measures of misconduct, there is no obvious

trend prior to the buyout, suggesting no evidence for non-parallel pre-trends. Furthermore, there is an obvious elevation of the misconduct measures starting two years after PE takeover, indicating PE takeovers affect adviser misconduct with some delay. This is not surprising because it takes some time for misconduct to be detected.

Figure 3 plots the coefficients $\beta_{1,t}$ in Eq. (7), using $\overline{D}(Misconduct)$ or $\overline{N}(Misconduct)$ as the dependent variable. Consistent with adviser level coefficient plots, there is no obvious pre-trend before the buyout, but the gaps in both the misconduct rate and the average misconduct incident count between the treated and the control firms widen starting in year $t+2$, suggesting a rise of misconduct intensity after takeovers.

4.4 Robustness Checks

To check the robustness of our results, we replicate all the results by changing the matching method and the event window. The results are displayed in Table 10.

In our benchmark DiD analysis, each treated firm is matched with up to four control firms when available. As a robustness check, we match each treated firm to no more than two control firms. This approach allows stronger comparability between the treated and the control firms, at the expense of more noisy coefficient estimates due to fewer observations. Nevertheless, the results under this alternative approach, reported in panel A of Table 10, are very similar to those in Tables 6 and 7, both in the point estimates of the coefficients and the statistical significance.

Furthermore, in our benchmark DiD analysis, we examine an event window of ten years around the buyout. As a robustness check, we shrink the event window to six years, from year t-2 to t+3. The results, reported in panel B of Table 10, are qualitatively very similar to those reported in Tables 6 and 7. Quantitatively, the estimated treatment effects are even stronger than in the benchmark case. For example, the coefficient on $\mathbf{1}\{Post\} \times \mathbf{1}\{Treated\}$ is 0.324 in column 1, compared to an estimate of 0.229 for the same coefficient in column 2 of Table 6.

To summarize, the results in this section show that while PE tends to target firms with less misconduct, there is a significant increase in misconduct activities, measured at both the adviser and the firm levels, after the PE buyout. As a result, the post-buyout misconduct intensity of the acquired firm is on par with the industry average.

5 Potential Mechanisms for Post-buyout Increase in Misconduct

We now explore the mechanisms behind the increase in misconduct activities after PE takeovers documented in the last section.

5.1 Adviser Composition Effect vs. Within-Adviser Effect

The post-buyout increase in misconduct can occur either because existing advisers commit more misconduct or because there is a change in adviser composition after the PE buyout. Our DiD analysis controlling for $Firm \times Cohort$ and $Year \times Cohort$ fixed effects does not separate the composition effect from the within-adviser effect. To disentangle these two effects, we further add $Adviser \times Cohort$ fixed effects to Eq. (2). Since this specification exploits only the variation in the same adviser before and after the PE buyout, the coefficient on $\mathbf{1}\{Post\} \times \mathbf{1}\{Treated\}$ is not affected by the change in the mix of advisers. As such, it measures the PE treatment effect on existing advisers.

Table 11 displays the results. After controlling for the adviser-cohort fixed effect, coefficients on $D(Misconduct)$, $N(Misconduct)$, $D(Regulatory)$ and $D(Customer)$ remain significantly positive. However, compared to the results in Table 6, the economic magnitudes of the coefficients on $D(Misconduct$, $N(Misconduct)$ decrease: from 0.229 to 0.204 for $D(Misconduct)$, and from 0.004 to 0.002 for $N(Misconduct)$. These differences imply that about 89% of the post-buyout increase in misconduct probability and 50% of the post-buyout increase in the average number of misconduct incidents at the adviser level are due to advisers that have worked in the firms both before and after the buyout. Therefore, both the composition effect and the direct effect on existing advisers contribute to the increased misconduct activities, suggesting that the PE effect on misconduct is not only due to turnover of advisers, but also due to behavioral changes of advisers staying at the firms after the buyout.

5.2 Business Growth and the PE Effect on Misconduct

One possible reason for the post-buyout increase misconduct is that PE firms pursue more aggressive growth plans, which puts more pressure on the advisers. To explore this possibility, we first examine whether the buyout has a significant effect on the size of the advisory business. We measure business size by the natural logarithms of the following variables, AUM (in 2020 dollars), 1 plus the number

of registered advisers based on our adviser database, and 1 plus the number of customers (when available). We regress these size measures on $\mathbf{1}\{Post\} \times \mathbf{1}\{Treated\}$, controlling for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects. Panel A in Table 12 shows a positive coefficient estimate on $\mathbf{1}\{Post\} \times \mathbf{1}\{Treated\}$ for all three dependent variables, although the effect is only statistically significant for AUM. Interestingly, the estimated PE growth effect is larger on the AUM (0.174 log points) and the number of customers (0.210 log points) than on the number of advisers (0.059 log points), suggesting an increase in business volume per adviser. This result is consistent with the notion that PE firms pursue business growth, but at the same time avoid substantial increases of operating costs. This potentially gives advisers more pressure and leads to more misconduct.

To further examine whether business expansion is a reason for the increased misconduct, we split the buyout deals into two groups based on the average annual growth rate of per adviser AUM in the post-buyout years (from t+1 up to t+5) relative to the median treated firm. We conduct the DiD analysis for the two subsamples separately and report the results in Panel B in Table 12. While the estimated PE buyout effect is statistically significant in both samples, its economic magnitude is 137% or 200% larger in the high growth sample than in the low growth sample, depending on the measure of misconduct intensity: the coefficients on $\mathbf{1}\{\text{Post}\}^*\mathbf{1}\{\text{Treated}\}$ are 0.329 and 0.139, respectively in columns 1 and 3; and 0.006 and 0.002, respectively, in columns 2 and 4. By running full-sample regressions using a three-way interaction term, we confirm that the difference in the treatment effect between the two samples is statistically significant (with a t-statistic of 1.75) when misconduct intensity is measured by misconduct probability $D(Misconduct)$, although it is insignificant (t-statistic=1.34) when the intensity is measured by the misconduct incident count $N(Misconduct)$. This result is consistent with the conjecture that aggressive business expansion after PE takeovers contributes to the elevated level of adviser misconduct.

5.3 Customer Type and the PE Effect on Misconduct

If the increased misconduct is a byproduct of PE firms aggressively pursuing profit maximization, we would expect the post-buyout increase in misconduct to be more severe when the customers are less financially sophisticated and more susceptible to misconduct. If customers are sophisticated, such as institutional investors, committing misconduct may more likely be caught and lead to a negative overall return to the advisory firm. In contrast, if customers are unsophisticated, such as retail

investors, misconduct is less likely to be caught and its overall NPV is positive from the firm's perspective. Consistent with this intuition, theoretical models by Stoughton et al. (2011) and Inderst and Ottaviani (2012) predict that advisers' misbehavior is a function of customer sophistication, making the unsophisticated investors more likely victims of financial adviser misconduct.

To test whether post-buyout increase in financial adviser misconduct is an outcome of intentional attempts to exploit unsophisticated customers, we divide the buyout targets into two groups based on whether they provide services to retail investors, which are likely less sophisticated than institutional customers, prior to the buyout. The results for these subsamples are reported in Table 13, and the difference between them is striking: the post-buyout increase in misconduct is only observed in treated firms whose clients include retail investors. For treated firms serving only institutional clients, misconduct activities actually decline significantly after the buyout. This result supports the notion that post-buyout increase in misconduct is an outcome of advisers' intentional choice based on customer sophistication, and suggests that negative impact of PE buyouts on adviser business conduct is mainly borne by unsophisticated investors.

5.4 Acquirer Characteristics and the PE Effect on Misconduct

The post-buyout increase in misconduct may also arise because the acquiring PE firms are not familiar with the advisory business, which leads to frictions and ineffective internal controls after the buyout. To test this possibility, we consider two sets of subsample analysis. First, we split our buyout deals into management buyouts (MBOs) and non-management buyouts. For management buyouts, the lack of expertise and experience is unlikely to be an issue, because the new owners were the managers of the acquired firm before the buyout deal. The DID regression results for the MBO vs. non-MBO subsamples, presented in Table 14, provide support for the idea that the acquiring PE firm's lack of experience in the advisory business may be a reason for the rise in misconduct. In the sample of management buyouts, there is no increase in misconduct after the buyout. The point estimates on the interaction term **1**{Post}*__1__{Treated} are either negative or very close to zero. The results for the non-management buyout sample are similar to those for the full sample. Therefore, the post-buyout increase in misconduct is entirely due to non-management buyouts, in which the new owners may be inexperienced in the advisory business.

Second, we split our buyout deals based on whether the lead PE firm is focused on the financial

advisory business. To do this, we examine the deal history of each lead PE firm in our sample using the Pitchbook database. A lead PE firm is defined as being focused if the target firms in over 50% of the deals that the firm participates in, up to the year when a deal we examine is made, belong to the industries related to financial advising (i.e., Asset Management, Brokerage, Investment Bank, and Consumer Finance).[9] The focused PE firms are likely to develop the expertise in the advisory business and exert more effective control on misconduct. Consistent with this conjecture, the results reported in Table 15 show that the post-buyout misconduct increase is only observed in the subsample of deals led by PE firms not focused on financial advisory business.

Other characteristics of the acquiring PE firms may also matter. In particular, one may expect that more established PE firms may care more about their reputation and thus impose stronger discipline of their advisers. To test this conjecture, we construct three measures to capture how established the lead PE firm of each deal is using the Pitchbook database: PE firm age, the number of deals that the PE firm has participated in, and the number of deals in which the PE firm has acted as the lead PE. We split the sample based on each of these measures observed in the year prior to each buyout deal. Somewhat surprisingly, we do not find any significant difference across the subsamples. The post-buyout increases in misconduct are similar for deals led by older and more established PE firms and for those led by younger and less established ones.

5.5 Other Operational Changes

The increased misconduct may also be due to other operational changes brought about by PE. In particular, previous literature(e.g., Stoughton et al. (2011), Inderst and Ottaviani (2012), and Egan (2019)) has shown that some compensation structures incentivize financial advisers to exploit customers. In an attempt to maximize profit, PE may alter advisers' behavior through aggressive incentive structures and thereby increase adviser misconduct. Furthermore, Dimmock and Gerken (2012) document that some business practices are more subject to conflict of interest, and thus more prone to financial adviser misconduct. It is possible that such business practices become more prevalent after PE takeovers. To examine these possibilities, we extract the information filed in ADV forms to capture firms' compensation structures and business practices prone to misconduct, and test whether they change significantly after the buyout.

[9] If a deal has multiple lead PE firms, we classify it into the focused PE sample as long as one of them is focused.

In Panel A of Table 16, we investigate whether PE takeovers have a significant effect on compensation structures. None of the compensation variables shows a significant PE effect. One potential reason for this non-result is that the dependent variables are only qualitative dummies, which by definition cannot capture any quantitative differences and tend to be highly persistent. For example, a firm may have performance-based compensation both before and after the buyout, but the details of how performance is evaluated and rewarded are very different.

To test whether PE expands business practices more prone to misconduct, we construct a set of business practice dummy variables that are potentially related to misconduct according to Dimmock and Gerken (2012), including whether a firm has interest in customer transactions, custody status, a dedicated Chief Compliance Officer (CCO), soft dollar arrangements, or referral fees. The dummy variable $\mathbf{1}\{\text{Interest in Transaction}\}$ indicates whether a firm trades directly with its clients or recommends securities in which it has an ownership or any other type of sales interest. $\mathbf{1}\{\text{Custody}\}$ indicates whether a firm has direct custody of its clients' assets. $\mathbf{1}\{\text{Dedicated CCO}\}$ is equal to one if a firm's CCO has no other job titles, which signals strong internal monitoring, and zero otherwise. $\mathbf{1}\{\text{Soft Dollar}\}$ is equal to one if a firm receives research or other products or services from a broker in connection with clients' securities transactions and zero otherwise. $\mathbf{1}\{\text{Referral Fee}\}$ is equal to one if a firm pays a third party for referring clients and zero otherwise.

Panel B in Table 16 shows how these business practices change after a PE buyout. No significant changes in business practices can be detected except that there is a significant increase in the probability of having a dedicated CCO. Supposedly, a dedicated CCO should improve an advisory firm's compliance controls. However, if the CCO appointed by the acquiring PE firm is relatively new to the industry, it may not be an effective defense against misconduct.

To summarize, our analysis in this section suggests that 89% of the post-buyout increase in misconduct probability and 50% of the increase in the misconduct incident count at the adviser level are due to behavioral changes of advisers who work in the acquired firm both before and after the buyout. Furthermore, our results also suggest a few potential channels through which PE ownership may exacerbate financial adviser misconduct: the aggressive post-buyout business expansion, the exploitation of unsophisticated retail customers, and the PE firms' lack of expertise in the advisory business.

6 Conclusion

We examine the effect of PE buyouts of advisory firms on financial adviser misconduct. We show that while PE tends to choose advisory firms with less misconduct as buyout targets, there is a sharp increase in adviser misconduct measured both at the adviser and the firm levels after the PE takeover. As a result, although the misconduct intensity of the acquired firms is only about 40% of the industry average before the buyout, it becomes on par with the industry average after the buyout. Regulatory misconduct and customer disputes are the two types of misconduct that drive the the post-buyout increase in misconduct. Further analysis controlling for adviser fixed effects shows that 89% of the increase in misconduct probability and 50% of the increase in the misconduct incident count at the adviser level are due to behavioral changes of advisers who have worked in the acquired firm both before and after the buyout.

The post-buyout increase in misconduct is more significant in firms with high growth in assets under management per adviser after the buyout, and it is concentrated in firms whose clients include retail customers, who are likely less financially sophisticated compared to institutional clients of the advisory business. The increase is also concentrated in non-management buyout deals and deals led by PE firms not focused on industries related to financial advising, suggesting that it is partly due to the acquiring firm's lack of expertise in the financial advisory business.

Overall, our results suggest that PE firms target advisory firms with a relatively clean record in terms of misconduct and operate their advisory business more aggressively after the takeover to maximize profits. As such, they suggest a tension between financial advisory firms' profit motive and ethical business practices, especially when clients are financially unsophisticated.

Appendices

A.1 Variable definitions

The following table summarizes the definitions of variables used in the paper. Indicator variables in the format of $\mathbf{1}\{\cdot\}$ are coded as 0 or 1, while those in the format of $\mathrm{D}(\cdot)$ are coded as 0 or 100.

Table A.1: Variable Definitions

Variable	Definition
D(Treated)	Indicator (0 or 100) for the firms acquired by PE in a given year
1{Treated}	Indicator (0 or 1) for the firms acquired by PE in the stacked DiD analysis
1{Post}	Indicator (0 or 1) for the post-buyout periods in the stacked DiD analysis
Individual-Level	
D(Misconduct)	Indicator for whether an adviser committed any misconduct in the year
M(Misconduct)	Total number of misconduct incidents of an adviser in the year
D(Misconduct Type)	Indicator for whether the adviser committed this type of misconduct in the year
Experience	Number of years since an adviser first registered with some advisory firm
1{State Law Exam 63}	Indicator for whether the adviser has passed Uniform Securities Agent State Law Exam by the year
1{IA Exam 65/66}	Indicator for whether the adviser has passed an investment adviser exam (Uniform Investment Adviser Exam (Series 65) or Combined State Law Exam (Series 66)) by the year
Firm-Level	
$\overline{D}$(Misconduct)	Percentage of advisers that commit one or more misconduct within the year (misconduct rate)
$\overline{N}$(Misconduct)	Average number of misconduct incidents across a firm's advisers in the year
$\overline{D}$(Misconduct Type)	Percentage of advisers to commit one or more this type of misconduct within the year
$\overline{\mathbf{1}}${State Law Exam 63}	fraction of the advisers that have passed Series 63 exam by the year
$\overline{\mathbf{1}}${IA Exam 65/66}	fraction of the advisers that have passed an investment adviser exam (Series 65 or 66) by the year
ln(AUM)	Logarithm of regulatory assets under management reported in the ADV filing (in year 2020 dollars)
ln(1+Nadv)	Logarithm of one plus total number of advisers in the adviser sample
ln(1+Cust)	Logarithm of one plus total number of customers reported in ADV filing
1{AUM-based}	Indicator for whether advisers are compensated by percentage of assets under management
1{Hourly}	Indicator for whether advisers are compensated by hourly charge
1{Fixed}	Indicator for whether advisers are compensated by fixed fees (other than subscription fees)
1{Commissions}	Indicator for whether advisers are compensated by commissions
1{Performance-based}	Indicator for whether advisers are compensated performance-based
1{Int in Tran}	Indicator for whether whether the firm has interest in clients' transactions
1{Custody}	Indicator for whether the firm has custody of any advisory clients' cash or securities
1{Dedicated CCO}	Indicator that equals one if the CCO has no other stated role in the firm and zero otherwise
1{Soft Dollar}	Indicator for whether the firm receives research or other products or services other than execution from a broker-dealer or a third party ("soft dollar benefits") in connection with client securities transactions.
1{Referral Fee}	Indicator for whether the firm compensates any person for client referrals

A.2 Misconduct types

The following table summarizes the definitions of five financial adviser misconduct types disclosed in the SEC's IAPD database.

Table A.2: Misconduct Type Description

Type	Definition
Civil	This type of disclosure event involves (1) an injunction issued by a court in connection with investment-related activity, (2) a finding by a court of a violation of any investment-related statute or regulation, or (3) an action brought by a state or foreign financial regulatory authority that is dismissed by a court pursuant to a settlement agreement.
Criminal	This type of disclosure event involves a formal charge for a crime involving a felony or certain misdemeanor offenses, including bribery, perjury, forgery, counterfeiting, extortion, fraud, and wrongful taking of property.
Regulatory	This type of disclosure event involves (1) a final, formal proceeding initiated by a regulatory authority (e.g., a state securities agency, self-regulatory organization, federal regulatory agency such as the SEC, foreign financial regulatory body) for a violation of investment-related rules or regulations or (2) a revocation or suspension of an adviser's authority to act as an attorney, accountant, or federal contractor.
Customer	This type of disclosure event (customer disputes) involves a consumer-initiated, investment-related arbitration or civil suit containing allegations of sales practice violations against the adviser that resulted in an arbitration award or civil judgment for the customer.
Termination	This type of disclosure event involves a situation in which the adviser voluntarily resigned, was discharged, or was permitted to resign after being accused of violating investment-related statutes, regulations, rules, or industry standards of conduct; fraud or the wrongful taking of property; or failure to supervise in connection with investment- related statutes, regulations, rules, or industry standards of conduct.

A disclosed event does not necessarily mean that an adviser commits a wrongdoing. Following Egan et al. (2019), we only consider the events in which the final resolution indicates a wrongdoing of the financial adviser. We call such cases the "confirmed cases." All termination cases are counted as confirmed cases. For civil, criminal, regulatory and customer dispute events, we first check the case status and exclude all the pending ones. We then examine the final resolution of each case. We identify a few key words indicating an outcome in favor of the advisers and exclude cases whose final resolutions include those key words. Specifically, we apply the following filters:

- **Civil:** We check the "Resolution" of each case and exclude the ones in which the resolution result is "Dismissed" or "Dropped". The rest are considered as confirmed cases.

- **Criminal:** We check the "Disposition Details" and exclude those where the disposition is "Dismissed","Not Guilty", "No Guilty", "Acquitted", "Nolle prosequi", or "Dropped". The rest are considered as confirmed cases. (For cases after around 2005, disposition details for multiple charges in a criminal case are disclosed separately. A case is excluded only if the dispositions of all charges satisfy this condition.)

- **Regulatory:** We check the "Resolution" of each case and exclude all the cases in which the resolution result is "Dismissed" or "Withdrawn". The rest are considered as confirmed cases.

- **Customer Dispute:** For customer dispute cases, the resolution results are reported under either "Status" or "Disposition", we check both and exclude all the cases in which the result is "Dismissed", "Denied", "Withdrawn", or "No action". The rest are considered as confirmed cases.

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Table 1: Summary statistics at the adviser-year level

This table reports summary statistics of 540,370 individual financial advisers in our sample, which is formed by matching the SEC Investment Adviser Public Disclosure database to the database of advisory firms constructed using annual Form ADV filings from 2000 to 2020. Observations are at the adviser-year level. p(99) represents the 99th percentile. D(Misconduct) is a dummy variable indicating whether an adviser commits any misconduct in the year. N(Misconduct) is the total number of misconduct incidents committed by an adviser in a year. D(Civil) is a dummy variable indicating whether an adviser commits regulatory misconduct in the year. Dummy variables for other specific misconduct types are defined accordingly. Experience is defined as the number of years since an adviser first registered. **1**{IA Exam 65/66} is a dummy variable indicating whether an adviser has passed an investment adviser exam (Series 65 or 66), which qualifies the individual as an investment adviser. **1**{State Law Exam 63} indicates whether an adviser has passed the Series 63 Exam, which qualifies an individual as a broker. All dummy variables are codes as either 0 or 100.

	mean	sd	min	median	p(99)	max	count
D(Misconduct)(%)	0.711	8.402	0	0	0	100	5,499,363
N(Misconduct)	0.008	0.129	0	0	0	77	5,499,363
D(Civil) (%)	0.002	0.469	0	0	0	100	5,499,363
D(Criminal) (%)	0.014	1.185	0	0	0	100	5,499,363
D(Regulatory) (%)	0.096	3.094	0	0	0	100	5,499,363
D(Customer) (%)	0.458	6.751	0	0	0	100	5,499,363
D(Termination) (%)	0.174	4.170	0	0	0	100	5,499,363
Experience (year)	12.437	9.644	0	11	39	60	5,499,363
1{IA Exam 65/66}	0.765	0.424	0	1	1	1	5,499,363
1{State Law Exam 63}	0.498	0.500	0	0	1	1	5,499,363

Table 2: Summary statistics at the firm-year level

This table reports summary statistics for the annual observations of 14,383 investment advisory firms for the fiscal years from 2000 to 2020. The sample is constructed by matching annual ADV filings with the SEC Investment Adviser Public Disclosure database. Observations are at the firm-year level. AUM is the regulatory asset under management reported in the ADV filing (in year 2020 dollars). Number of advisers is the total number registered advisers affiliated with the firm in each year according to the employment records of individual advisers. All the firm level misconduct variables are computed based on individual advisers working in that firm. p(99) represents the 99th percentile. $\overline{D}(Misconduct)$ is the percentage of advisers that commits any misconduct in a year. $\overline{N}(Misconduct)$ is the average number of misconduct incidents across the advisers. The firm level misconduct for each type, for example, $\overline{D}(Civil)$, is the average of corresponding dummy variable at the adviser level. $\overline{\mathbf{1}}\{$IA Exam 65/66$\}$ is the fraction of advisers that have passed the Series 65 or 66 exam, which qualifies an individual as investment advisers. $\overline{\mathbf{1}}\{$State Law Exam 63$\}$ is the fraction of advisers that have passed the Series 63 exam, which qualifies an individual as a broker.

	mean	sd	min	median	p(99)	max	count
AUM ($ Million)	4,289	372,98	0	241	85,144	2,452,431	115,803
Number of Advisers	46.496	606.186	1	3	707	30,602	118,277
$\overline{D}$(Misconduct)(%)	0.454	4.801	0	0	9.091	100	118,277
$\overline{N}$(Misconduct)	0.005	0.065	0	0	0.111	9	118,277
$\overline{D}$(Civil) (%)	0.011	0.810	0	0	0.000	100	118,277
$\overline{D}$(Criminal) (%)	0.007	0.523	0	0	0.000	100	118,277
$\overline{D}$(Regulatory) (%)	0.171	3.095	0	0	0.847	100	118,277
$\overline{D}$(Customer) (%)	0.214	3.263	0	0	2.348	100	118,277
$\overline{D}$(Termination) (%)	0.063	1.440	0	0	0.424	100	118,277
$\overline{\mathbf{1}}\{$IA Exam 65/66$\}$	0.671	0.365	0	1	1.000	1	118,277
$\overline{\mathbf{1}}\{$State Law Exam 63$\}$	0.207	0.305	0	0	1.000	1	118,277

Table 3: Misconduct and buyout probability

This table displays the regression results for a linear probability model (Eq. (1)), which measures how the firms' misconduct record in year $t-1$ impacts the probability of a PE buyout in year t. Observations for the post-buyout years are dropped from the sample. The dependent variable is an indicator variable coded as 100 if an advisory firm is acquired in year t and zero otherwise. The independent variable $\overline{D}(Misconduct)$ measures the percentage of advisers that commit any misconduct in a given year, and $\overline{N}(Misconduct)$ measures the average number of misconduct across all advisers. AUM, $Nadv$, and $AUM\ Growth$ are assets under management, number of advisers, and AUM growth rate measured in year $t-1$. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)
	D(Treated)	D(Treated)	D(Treated)	D(Treated)
$\overline{D}$(Misconduct)$_{-1}$	-0.002**	-0.002**		
	(-2.38)	(-1.96)		
$\overline{D}$(Misconduct)$_{-2}$	-0.001***	-0.001**		
	(-2.71)	(-2.30)		
$\overline{D}$(Misconduct)$_{-3}$	-0.001***	-0.001		
	(-2.58)	(-1.53)		
$\overline{N}$(Misconduct)$_{-1}$			-0.147***	-0.157***
			(-3.16)	(-2.85)
$\overline{N}$(Misconduct)$_{-2}$			-0.134***	-0.143***
			(-3.33)	(-3.07)
$\overline{N}$(Misconduct)$_{-3}$			-0.066*	-0.038
			(-1.87)	(-1.00)
AUM Growth		-0.080*		-0.080*
		(-1.73)		(-1.73)
ln(AUM)		0.057***		0.057***
		(4.45)		(4.45)
ln(1+Nadv)		0.077***		0.077***
		(3.60)		(3.60)
Constant	0.185***	-0.273***	0.185***	-0.274***
	(13.42)	(-4.16)	(13.42)	(-4.17)
Observations	97654	90773	97654	90773
R^2	0.001	0.002	0.001	0.002
Year FE	Yes	Yes	Yes	Yes

Table 4: Misconduct and buyout probability by misconduct type

This table shows the impact of misconduct on the probability of a PE buyout by misconduct type. Observations for the post-buyout years are dropped from the sample. The dependent variable is an indicator variable coded as 100 if an advisory firm is acquired in year t and zero otherwise. The independent variable measures the percentage of advisers committing a specific type of misconduct in year $t-1$. All models control for lagged $ln(AUM)$, $ln(1+Nadv)$, and $AUM\ Growth$, as well as $Year$ fixed effects. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)
	D(Treated)	D(Treated)	D(Treated)	D(Treated)	D(Treated)
$\overline{D}$(Civil)$_{-1}$	-0.001				
	(-1.26)				
$\overline{D}$(Civil)$_{-2}$	-0.003***				
	(-2.75)				
$\overline{D}$(Civil)$_{-3}$	0.023				
	(0.93)				
$\overline{D}$(Criminal)$_{-1}$		-0.006			
		(-1.28)			
$\overline{D}$(Criminal)$_{-2}$		-0.020**			
		(-2.12)			
$\overline{D}$(Criminal)$_{-3}$		-0.004			
		(-0.55)			
$\overline{D}$(Regulatory)$_{-1}$			-0.002***		
			(-3.52)		
$\overline{D}$(Regulatory)$_{-2}$			-0.002***		
			(-3.98)		
$\overline{D}$(Regulatory)$_{-3}$			-0.001***		
			(-3.64)		
$\overline{D}$(Customer)$_{-1}$				-0.000	
				(-0.23)	
$\overline{D}$(Customer)$_{-2}$				-0.000	
				(-0.04)	
$\overline{D}$(Customer)$_{-3}$				-0.001	
				(-1.34)	
$\overline{D}$(Termination)$_{-1}$					-0.006***
					(-3.53)
$\overline{D}$(Termination)$_{-2}$					-0.007***
					(-4.16)
$\overline{D}$(Termination)$_{-3}$					-0.002
					(-1.55)
AUM Growth	-0.082*	-0.082*	-0.082*	-0.082*	-0.082*
	(-1.76)	(-1.76)	(-1.76)	(-1.76)	(-1.75)
ln(AUM)	0.059***	0.059***	0.059***	0.059***	0.059***
	(4.50)	(4.50)	(4.47)	(4.49)	(4.48)
ln(1+Nadv)	0.076***	0.076***	0.076***	0.076***	0.077***
	(3.47)	(3.47)	(3.47)	(3.47)	(3.49)
Constant	-0.285***	-0.284***	-0.282***	-0.284***	-0.283***
	(-4.27)	(-4.27)	(-4.23)	(-4.25)	(-4.25)
Observations	90773	90773	90773	90773	90773
R^2	0.003	0.003	0.003	0.003	0.003
Year FE	Yes	Yes	Yes	Yes	Yes

Table 5: Pre-treatment comparison

This table shows the comparison between firms in the treatment and the control groups in the year prior to the PE buyout. Up to 4 controls are chosen for each treated firm based on state, year, AUM, and misconduct record.

	mean(Treated)	mean(Control)	difference	t-stat
AUM ($ Million)	17984.083	15251.774	2732.310	0.65
Number of Advisers	250.000	140.892	109.108	0.95
$\overline{D}$(Misconduct)(%)	0.189	0.106	0.083	1.19
$\overline{N}$(Misconduct)	0.002	0.001	0.001	0.54
$\overline{D}$(Civil) (%)	0.000	0.000	0.000	.
$\overline{D}$(Criminal) (%)	0.000	0.005	-0.005	-0.86
$\overline{D}$(Regulatory) (%)	0.037	0.023	0.014	0.37
$\overline{D}$(Customer) (%)	0.098	0.043	0.055	1.81
$\overline{D}$(Termination) (%)	0.061	0.045	0.016	0.35
$\overline{\mathbf{1}}${IA Exam 65/66}	0.675	0.666	0.009	0.18
$\overline{\mathbf{1}}${State Law Exam 63)}	0.238	0.170	0.068	1.84
Observations	57	204		

Table 6: PE effect on misconduct: DID at the adviser level

This table displays the regression results from stacked DID analysis measuring the PE buyout effect on misconduct at the adviser level (Eq. (2)). The dependent variable D(Misconduct) is an indicator variable equal to 100 if an adviser commits any misconduct in a given year and zero otherwise, and N(Misconduct) is the number of misconduct incidents reported by an adviser in a given year. The dummy variable $\mathbf{1}\{Post\}$ is equal to one for the post-buyout periods ($t+1$ to $t+5$) and zero for the pre-buyout periods ($t-4$ to t), $\mathbf{1}\{Treated\}$ is equal to one for the the acquired firms and zero for the control firms. We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Observations are at the adviser-year level. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)
	D(Misconduct)	D(Misconduct)	N(Misconduct)	N(Misconduct)
1{Post} × **1**{Treated}	0.221***	0.229***	0.004**	0.004**
	(4.30)	(4.30)	(2.31)	(2.33)
ln(1+Experience)		0.229***		0.003***
		(6.33)		(5.79)
1{IA Exam 65/66}		0.095***		0.001***
		(4.13)		(3.01)
1{State Law Exam 63}		-0.254***		-0.004***
		(-5.00)		(-4.51)
Constant	0.513***	0.037	0.006***	0.000
	(52.77)	(0.46)	(19.18)	(0.35)
Observations	444815	444815	444815	444815
R^2	0.003	0.003	0.003	0.003
Time-Cohort FE	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes

Table 7: PE effect on misconduct: DID at the adviser level by misconduct type

This table displays the regression results from stacked DID analysis measuring PE buyout effect on each type of misconduct using adviser level observations. The dependent variable is an indicator variable equal to 100 if an adviser commits a specific type of misconduct in a given year and zero otherwise. The dummy variable $\mathbf{1}\{Post\}$ is equal to one for the post-buyout periods ($t+1$ to $t+5$) and zero for the pre-buyout periods ($t-4$ to t), $\mathbf{1}\{Treated\}$ is equal to one for the the acquired firms and zero for the control firms. We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Observations are at the adviser-year level. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)
	D(Civil)	D(Criminal)	D(Regulatory)	D(Customer)	D(Termination)
1{Post} × **1**{Treated}	0.001	-0.003	0.152***	0.112**	0.024
	(0.75)	(-0.22)	(5.07)	(2.45)	(0.73)
ln(1+Experience)	-0.001	-0.003	0.034***	0.173***	0.043***
	(-0.57)	(-0.91)	(5.02)	(6.43)	(4.57)
1{IA Exam 65/66}	0.001	-0.005	-0.002	0.081***	0.013
	(0.75)	(-0.79)	(-0.15)	(4.21)	(1.09)
1{State Law Exam 63}	0.003	-0.019***	-0.084***	-0.063*	-0.147***
	(0.75)	(-3.77)	(-6.46)	(-1.79)	(-6.53)
Constant	0.002*	0.035***	0.021	-0.108	0.097***
	(1.74)	(3.91)	(1.16)	(-1.63)	(4.11)
Observations	444815	444815	444815	444815	444815
R^2	0.010	0.001	0.002	0.003	0.002
Year-Cohort FE	Yes	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes	Yes

Table 8: PE effect on misconduct: DID at the firm level

This table displays the weighted regression results from stacked DID analysis measuring PE buyout effect on misconduct measured at the firm level (Eq. (3)). In columns 1 and 2, the dependent variable $\overline{D}(Misconduct)$ is the percentage of a firm's advisers that commit any misconduct in a given year. In columns 3 and 4, the dependent variable $\overline{N}(Misconduct)$ is the average number of misconduct across a firm's advisers in a given year. We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Observations are at the firm-year level and are weighted by the number of advisers in the firm. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)
	$\overline{D}$(Misconduct)	$\overline{D}$(Misconduct)	$\overline{N}$(Misconduct)	$\overline{N}$(Misconduct)
$\mathbf{1}\{\text{Post}\} \times \mathbf{1}\{\text{Treated}\}$	0.266***	0.277***	0.004**	0.004**
	(3.25)	(3.44)	(2.29)	(2.09)
ln(AUM)		-0.013		-0.001
		(-0.23)		(-0.87)
ln(1+Nadv)		0.178*		0.002
		(1.72)		(1.53)
Constant	0.503***	-0.719	0.006***	-0.006
	(33.72)	(-0.76)	(19.58)	(-0.44)
Observations	2249	2230	2249	2230
R^2	0.736	0.732	0.602	0.598
Time-Cohort FE	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes

Table 9: PE effect on misconduct: DID at the firm level by misconduct type

This table displays the weighted regression results from stacked DID analysis measuring PE buyout effect on different types of misconduct, respectively. The dependent variables are the percentage of advisers that commit a specific type of misconduct in a given year. The dummy variable $\mathbf{1}\{Post\}$ is equal to one for the post-buyout periods ($t+1$ to $t+5$) and zero for the pre-buyout periods ($t-4$ to t), $\mathbf{1}\{Treated\}$ is equal to one for the the acquired firms and zero for the control firms. We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Observations are at the firm-year level and are weighted by the number of advisers in the firm. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)
	$\overline{D}$(Civil)	$\overline{D}$(Criminal)	$\overline{D}$(Regulatory)	$\overline{D}$(Customer)	$\overline{D}$(Termination)
$\mathbf{1}\{\text{Post}\} \times \mathbf{1}\{\text{Treated}\}$	0.003	0.019	0.108***	0.129*	0.053
	(1.21)	(1.13)	(3.31)	(1.67)	(1.43)
ln(AUM)	0.003	-0.003	-0.016	-0.017	0.002
	(1.49)	(-0.29)	(-0.74)	(-0.32)	(0.07)
ln(1+Nadv)	-0.004	-0.029	-0.028	0.139	0.101*
	(-0.53)	(-1.37)	(-0.67)	(1.46)	(1.79)
Constant	0.002	0.258*	0.441	-0.567	-0.650
	(0.04)	(1.65)	(1.06)	(-0.59)	(-1.30)
Observations	2230	2230	2230	2230	2230
R^2	0.455	0.352	0.440	0.743	0.688
Time-Cohort FE	Yes	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes	Yes

Table 10: DiD analysis: Robustness tests

This table displays the results for robustness check. All the specifications replicate Eq. (1). The dummy variable $\mathbf{1}\{Post\}$ is equal to one for the post-buyout periods ($t+1$ to $t+5$) and zero for the pre-buyout periods ($t-4$ to t), $\mathbf{1}\{Treated\}$ is equal to one for the the acquired firms and zero for the control firms. In panel A, we adopt an alternative matching procedure by matching each treated firm to up to two control firms. In panel B, we reduce the event window from ten to six years (from year t-2 to t+3). We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Observations are at the adviser-year level. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Panel A: One-to-two match

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	D(Misconduct)	N(Misconduct)	D(Civil)	D(Criminal)	D(Regulatory)	D(Customer)	D(Termination)
1{Post} × **1**{Treated}	0.226***	0.004*	0.004	-0.005	0.156***	0.089*	0.035
	(3.51)	(1.88)	(0.77)	(-0.29)	(4.66)	(1.91)	(1.01)
ln(1+Experience)	0.260***	0.003***	-0.001	-0.004	0.039***	0.197***	0.049***
	(7.15)	(6.54)	(-0.52)	(-1.28)	(5.15)	(7.05)	(5.63)
1{IA Exam 65/66}	0.106***	0.001***	0.002	-0.004	-0.005	0.097***	0.009
	(3.88)	(2.96)	(0.74)	(-0.53)	(-0.47)	(4.95)	(0.75)
1{State Law Exam 63}	-0.267***	-0.004***	0.003	-0.016***	-0.094***	-0.069*	-0.147***
	(-4.42)	(-4.01)	(0.74)	(-3.99)	(-6.91)	(-1.66)	(-5.58)
Constant	-0.007	-0.000	0.002	0.037***	0.017	-0.137**	0.081***
	(-0.09)	(-0.18)	(1.35)	(3.46)	(0.79)	(-2.09)	(3.97)
Observations	374250	374250	374250	374250	374250	374250	374250
R^2	0.003	0.003	0.012	0.002	0.002	0.003	0.002
Time-Cohort FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes

panel B: Six-year window (years t-2 to t+3)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	D(Misconduct)	N(Misconduct)	D(Civil)	D(Criminal)	D(Regulatory)	D(Customer)	D(Termination)
1{Post} × **1**{Treated}	0.324***	0.005**	0.002	0.005	0.164***	0.190***	0.029
	(4.51)	(2.31)	(0.84)	(0.28)	(4.98)	(3.35)	(0.68)
ln(1+Experience)	0.243***	0.003***	0.000	-0.004	0.036***	0.195***	0.037***
	(5.46)	(4.84)	(0.36)	(-1.24)	(4.83)	(5.65)	(3.14)
1{IA Exam 65/66}	0.130***	0.002***	-0.001	-0.013	0.007	0.095***	0.047***
	(4.08)	(4.66)	(-1.02)	(-1.32)	(0.60)	(2.70)	(3.12)
1{State Law Exam 63}	-0.248***	-0.004***	-0.002	-0.020***	-0.074***	-0.069**	-0.140***
	(-4.80)	(-4.04)	(-0.64)	(-3.58)	(-5.11)	(-2.20)	(-4.61)
Constant	-0.012	-0.000	0.002	0.047***	0.007	-0.156*	0.084***
	(-0.12)	(-0.36)	(1.58)	(3.86)	(0.44)	(-1.69)	(2.74)
Observations	276740	276740	276740	276740	276740	276740	276740
R^2	0.004	0.003	0.017	0.001	0.002	0.003	0.002
Time-Cohort FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Table 11: PE effect on misconduct: Controlling for adviser-fixed effects

This table displays the regression results from stacked DID analysis measuring PE buyout effect on individual advisers' misconduct (Eq. (2)). We control $Adviser \times Cohort$ fixed effects, in addition to $Time \times Cohort$, $Firm \times Cohort$. We use D(Misconduct), N(Misconduct), and indicator variables (coded as 0 or 100) for each type of misconduct as the dependent variable. The dummy variable $\mathbf{1}\{Post\}$ is equal to one for the post-buyout periods ($t+1$ to $t+5$) and zero for the pre-buyout periods ($t-4$ to t), $\mathbf{1}\{Treated\}$ is equal to one for the acquired firms and zero for the control firms. Observations are at the adviser-year level. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	D(Misconduct)	N(Misconduct)	D(Civil)	D(Criminal)	D(Regulatory)	D(Customer)	D(Termination)
1{Post} × **1**{Treated}	0.204***	0.002***	0.002	0.005	0.161***	0.143***	-0.071
	(3.83)	(5.26)	(0.85)	(0.42)	(4.34)	(3.09)	(-1.00)
ln(1+Experience)	0.236***	0.003***	0.002	-0.012	0.058**	0.161***	0.055
	(3.62)	(3.22)	(1.08)	(-0.97)	(2.24)	(4.05)	(1.58)
1{IA Exam 65/66}	-0.115	-0.002*	0.015	-0.017	-0.034	0.008	-0.137***
	(-1.35)	(-1.86)	(0.80)	(-0.70)	(-1.33)	(0.11)	(-3.43)
1{State Law Exam 63}	0.125	0.001	-0.008	-0.014	0.066	0.108	-0.053
	(1.16)	(0.85)	(-0.95)	(-0.86)	(1.17)	(1.30)	(-1.03)
Constant	-0.032	-0.000	-0.009	0.058*	-0.091	-0.116	0.131
	(-0.18)	(-0.06)	(-0.62)	(1.94)	(-1.28)	(-1.06)	(1.64)
Observations	427004	427004	427004	427004	427004	427004	427004
R^2	0.244	0.295	0.225	0.266	0.257	0.217	0.276
Time-Cohort FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adviser-Cohort FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Table 12: Business growth and the PE effect on misconduct

This table shows the effect of PE buyout on firm growth (Panel A) and the PE effects on high vs. low growth treated firms (Panel B). In panel A, three firm size measures are used as the dependent variables: AUM, the number of advisers, and the number of customers. In panel B, we divide the treated firms into a low growth and a high growth sample based on the firm's average post-buyout growth rate of per adviser AUM (relative to the median treated firm), and perform the stacked DID analysis for the two samples separately. The dependent variable D(Misconduct) is an indicator variable equal to 100 if an adviser commits any misconduct in a given year and zero otherwise, and N(Misconduct) is the number of misconduct incidents reported by an adviser in a given year. We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Panel A. Business growth after buyouts

	(1)	(2)	(3)
	ln(AUM)	ln(1+Nadv)	ln(1+Cust)
1{Post} × **1**{Treated}	0.174*	0.059	0.210
	(1.87)	(0.86)	(1.22)
Constant	8.368***	2.777***	7.662***
	(944.38)	(420.57)	(368.47)
Observations	2230	2249	1448
R^2	0.932	0.981	0.946
Time-Cohort FE	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes

Panel B: High vs. low growth firms

	Low post-buyout growth sample		High post-buyout growth sample	
	(1)	(2)	(3)	(4)
	D(Misconduct)	N(Misconduct)	D(Misconduct)	N(Misconduct)
1{Post} × **1**{Treated}	0.139***	0.002**	0.329***	0.006*
	(3.87)	(2.25)	(3.23)	(1.93)
ln(1+Experience)	0.233***	0.003***	0.219***	0.002***
	(5.65)	(5.31)	(3.39)	(3.26)
1{IA Exam 65/66}	0.100***	0.001***	0.091	0.000
	(4.06)	(4.15)	(1.51)	(0.29)
1{State Law Exam 63}	-0.231***	-0.003***	-0.314***	-0.004***
	(-3.90)	(-3.48)	(-3.07)	(-2.94)
Constant	0.066	0.000	-0.016	0.001
	(0.68)	(0.41)	(-0.13)	(0.31)
Observations	311598	311598	133217	133217
R^2	0.002	0.002	0.006	0.006
Time-Cohort FE	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes

Table 13: Customer type and the PE effect on misconduct

This table displays the stacked DiD regression results on two subsamples, split based on whether the treated firm serves retail clients before the buyout. The dependent variable D(Misconduct) is an indicator variable equal to 100 if an adviser commits any misconduct in a given year and zero otherwise, and N(Misconduct) is the number of misconduct incidents reported by an adviser in a given year. Observations are at the adviser-year level. We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	Treated firms without retail clients		Treated firms with retail clients	
	(1)	(2)	(3)	(4)
	D(Misconduct)	N(Misconduct)	D(Misconduct)	N(Misconduct)
1{Post} × **1**{Treated}	-0.162***	-0.002***	0.248***	0.004**
	(-10.46)	(-10.46)	(4.58)	(2.36)
ln(1+Experience)	0.003	0.000	0.244***	0.003***
	(0.15)	(0.15)	(7.40)	(6.74)
1{IA Exam 65/66}	0.092	0.001	0.095***	0.001***
	(0.86)	(0.86)	(4.11)	(2.98)
1{State Law Exam 63}	0.035	0.000	-0.268***	-0.004***
	(1.28)	(1.28)	(-5.46)	(-4.85)
Constant	-0.047	-0.000	0.027	0.000
	(-0.35)	(-0.35)	(0.36)	(0.24)
Observations	19739	19739	425076	425076
R^2	0.009	0.009	0.003	0.003
Time-Cohort FE	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes

Table 14: PE effect on misconduct: Management buyouts vs. other deals

This table displays the stacked DiD results on two subsamples split based on whether the deal type is management buyout. The dependent variable D(Misconduct) is an indicator variable equal to 100 if an adviser commits any misconduct in a given year and zero otherwise, and N(Misconduct) is the number of misconduct incidents reported by an adviser in a given year. Observations are at the adviser-year level. We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	Management buyout deals		Other PE buyout deals	
	(1)	(2)	(3)	(4)
	D(Misconduct)	N(Misconduct)	D(Misconduct)	N(Misconduct)
1{Post} × **1**{Treated}	-0.048	0.001	0.248***	0.004**
	(-0.42)	(0.36)	(4.38)	(2.28)
ln(1+Experience)	0.288**	0.003**	0.223***	0.003***
	(2.32)	(2.29)	(6.28)	(5.64)
1{IA Exam 65/66}	0.047	0.000	0.099***	0.001***
	(0.45)	(0.27)	(4.13)	(3.01)
1{State Law Exam 63}	-0.438**	-0.005**	-0.239***	-0.003***
	(-2.46)	(-2.46)	(-4.65)	(-4.17)
Constant	0.142	0.002	0.031	0.000
	(0.58)	(0.74)	(0.38)	(0.25)
Observations	34516	34516	410299	410299
R^2	0.008	0.008	0.003	0.003
Time-Cohort FE	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes

Table 15: PE effect on misconduct: Focused vs. unfocused PE firms

This table displays the stacked DiD results on two subsamples split based on whether a deal is led by a PE firm with a focus on the financial advisory business. A lead PE firm is defined as a focused one if the target firms in over 50% of the deals that the firm participates in, up to the year when a deal we examine is made, belong to the industries related to financial advising. Otherwise, it is classified as an unfocused PE firm. The dependent variable D(Misconduct) is an indicator variable equal to 100 if an adviser commits any misconduct in a given year and zero otherwise, and N(Misconduct) is the number of misconduct incidents reported by an adviser in a given year. Observations are at the adviser-year level. We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

	Deals led by FA-focused PE firms		Deals led by unfocused PE firms	
	(1)	(2)	(3)	(4)
	D(Misconduct)	N(Misconduct)	D(Misconduct)	N(Misconduct)
1{Post} × **1**{Treated}	-0.058	0.003	0.266***	0.004**
	(-0.65)	(1.26)	(4.41)	(2.12)
ln(1+Experience)	0.270***	0.003***	0.225***	0.003***
	(3.58)	(3.44)	(5.68)	(5.17)
1{IA Exam 65/66}	0.157*	0.002*	0.087***	0.001**
	(1.78)	(1.95)	(4.12)	(2.57)
1{State Law Exam 63}	-0.258*	-0.004**	-0.254***	-0.004***
	(-1.74)	(-2.11)	(-4.73)	(-4.15)
Constant	-0.070	-0.002	0.053	0.001
	(-0.62)	(-0.96)	(0.60)	(0.53)
Observations	46611	46611	398204	398204
R^2	0.006	0.006	0.003	0.003
Time-Cohort FE	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes

Table 16: PE buyouts and other operational changes

This table shows the PE buyout effect on compensation structure and business practices potentially related to misconduct. All dependent variables are dummy variables described in A.1. Panel A focuses on the compensation structure set by firms. Panel B focuses on business practices potentially related to misconduct according to Dimmock et al. (2018). We control for $Time \times Cohort$ and $Firm \times Cohort$ fixed effects in all models. Standard errors are clustered by firm and t-statistics are reported in parentheses. Statistical significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Panel A. Compensation structure

	(1)	(2)	(3)	(4)	(5)
	1{AUM-based}	**1**{Hourly}	**1**{Fixed}	**1**{Commission}	**1**{Performance-based}
1{Post} × **1**{Treated}	-0.015	0.001	0.019	0.003	0.008
	(-0.65)	(0.02)	(0.49)	(0.09)	(0.19)
Constant	0.990***	0.296***	0.540***	0.083***	0.364***
	(448.42)	(82.93)	(139.68)	(22.73)	(89.58)
Observations	2249	2249	2249	2249	2249
R^2	0.749	0.926	0.897	0.909	0.875
Time-Cohort FE	Yes	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes	Yes

Panel B. Other business practices

	(1)	(2)	(3)	(4)	(5)
	1{Int in Transact}	**1**{Custody}	**1**{Dedicated CCO}	**1**{Soft Dollar}	**1**{Referral Fee}
1{Post} × **1**{Treated}	-0.010	-0.083	0.236***	-0.025	0.060
	(-0.28)	(-1.26)	(3.36)	(-0.53)	(1.05)
Constant	0.904***	0.546***	0.445***	0.656***	0.706***
	(257.77)	(85.33)	(65.66)	(145.21)	(127.43)
Observations	2249	2249	2249	2249	2249
R^2	0.791	0.751	0.736	0.845	0.745
Time-Cohort FE	Yes	Yes	Yes	Yes	Yes
Firm-Cohort FE	Yes	Yes	Yes	Yes	Yes

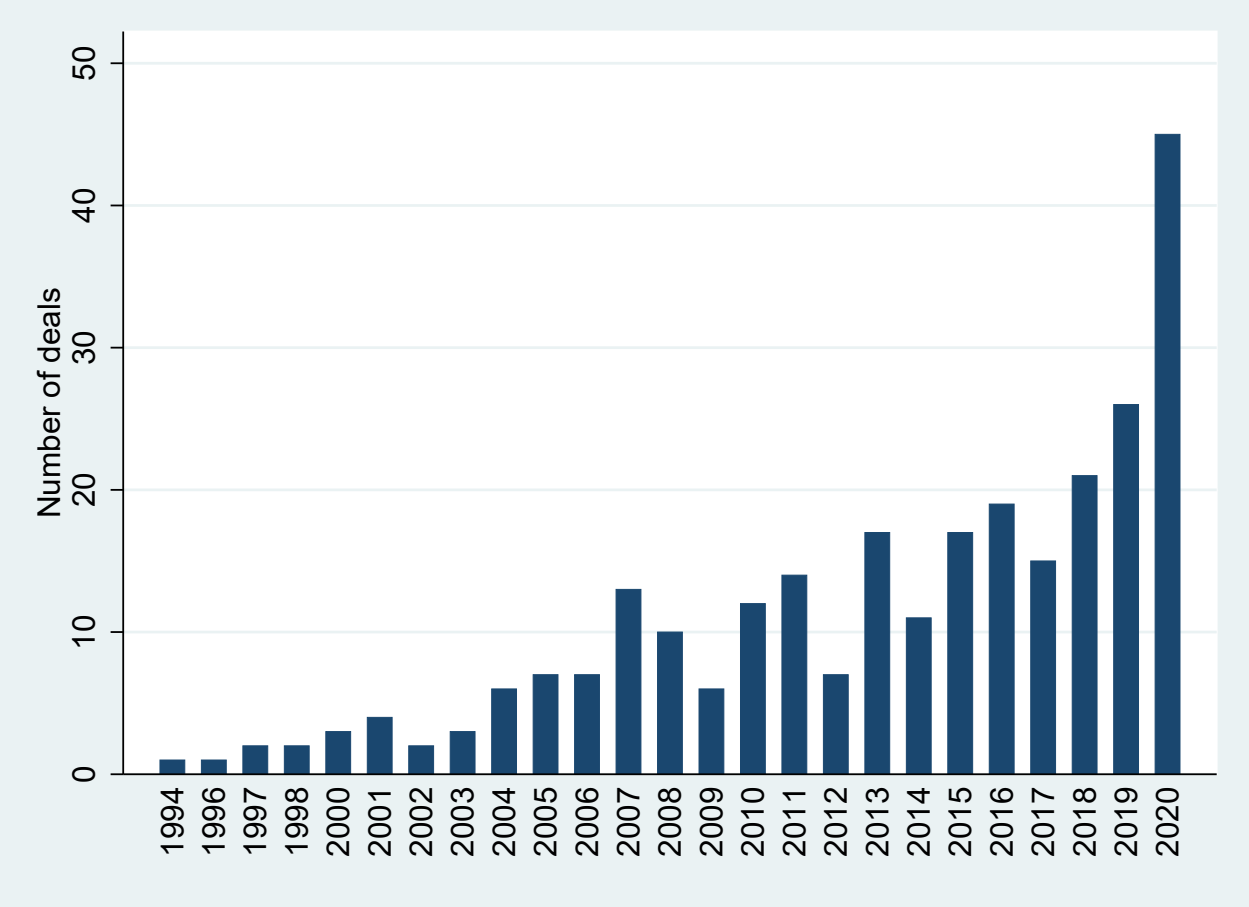
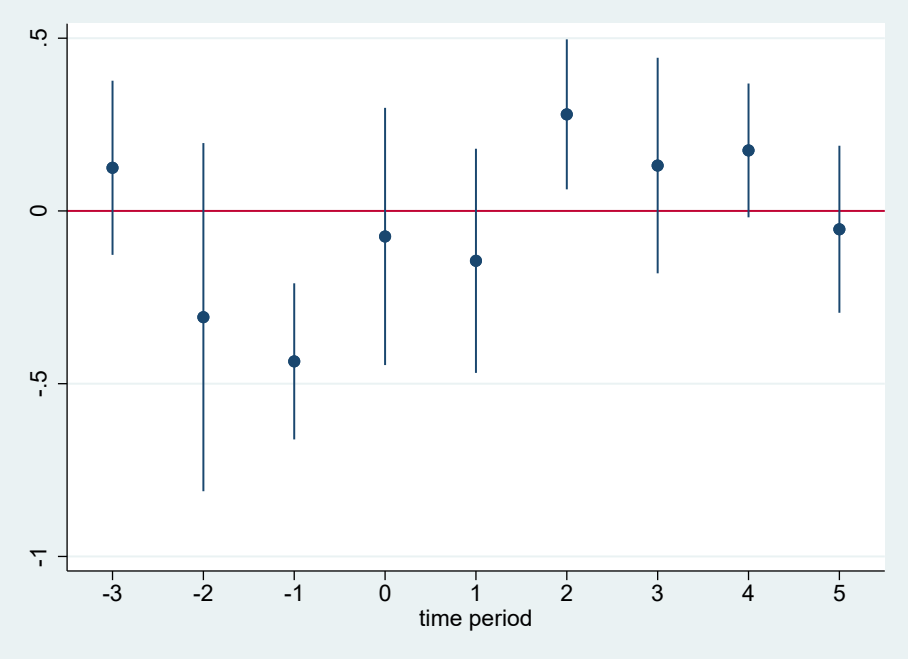
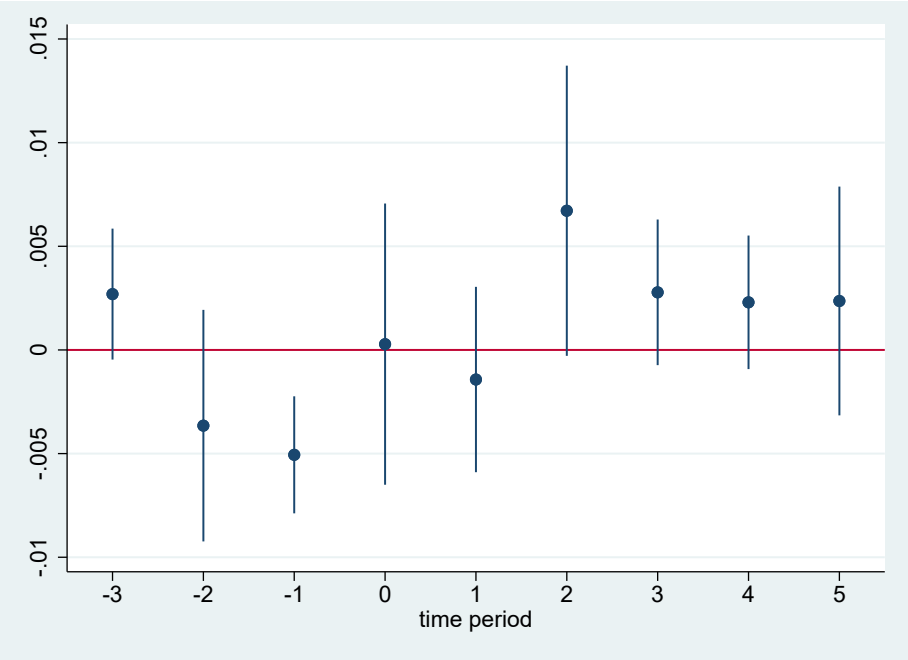


Figure 1: **Number of PE-backed Buyouts by Year**. This figure shows the number of PE-backed buyout deals over time in which the targets are investment advisory firms headquartered in the US that filed at least one ADV form during the fiscal years from 2000 to 2020.

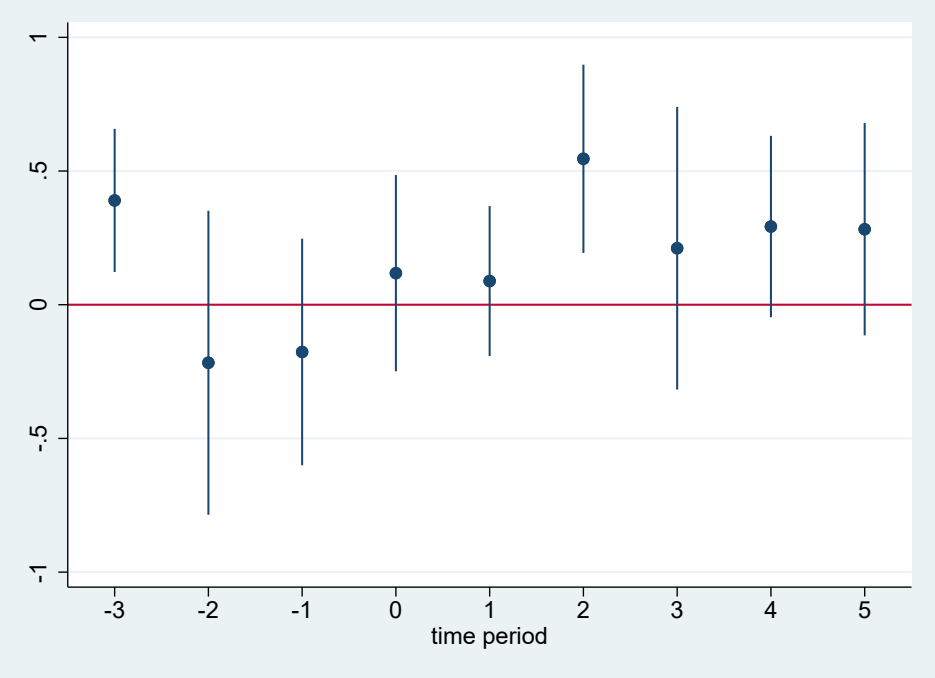


(A) Effect on misconduct indicator

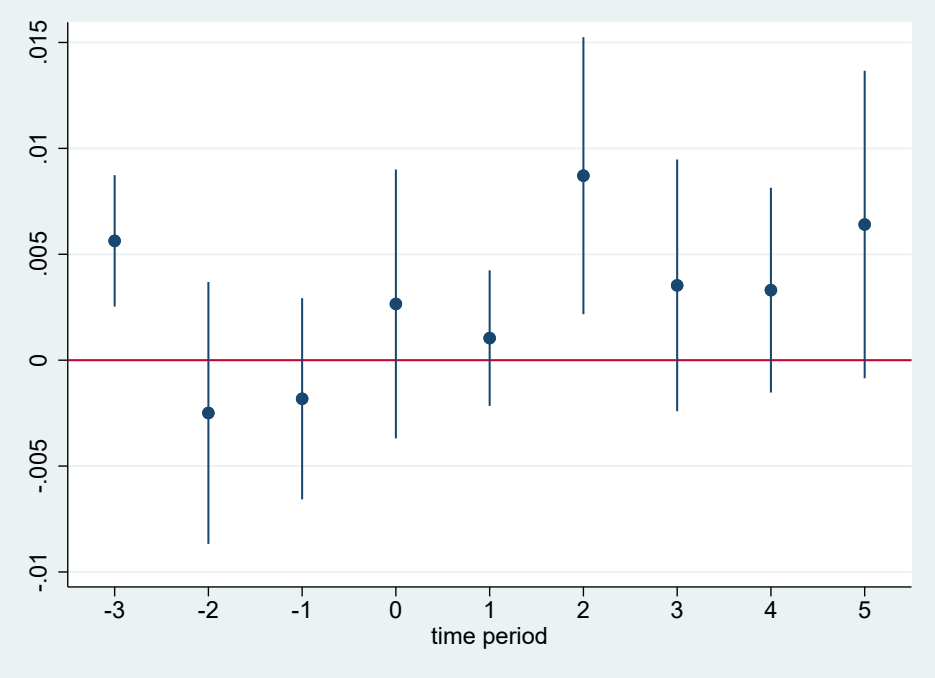


(B) PE effect on misconduct incident count

Figure 2: **Adviser-level DiD analysis: Coefficient plot**. This figure plots the coefficient estimates for $\beta_{1,t}$ in Eq. ((6), using either $D(Misconduct)_{j,c,t}$ (Panel A) or $N(Misconduct)_{j,c,t}$ (Panel B) as the dependent variable. Observations are at the adviser-year level.



(A) PE effect on misconduct rate



(B) PE effect on average misconduct incident count

Figure 3: **Firm-level DiD analysis: Coefficient plot.** This figure plots the coefficient estimates for $\beta_{1,t}$ in Eq. (7), using either $\overline{D}(Misconduct)_{i,c,t}$ (Panel A) or $\overline{N}(Misconduct)_{i,c,t}$ (Panel B) as the dependent variable. Observations are at the firm-year level and are weighted by the number of advisers in the firm.