Behavioral Biases and Financial Advisor Misconduct[Ψ]

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Abstract

Some financial advisor misconduct may reflect biases toward local stocks by sell-side analysts, advisors, and clients rather than unethical behavior by advisors. Research shows that both individual and professional investors overweight local stocks. Other studies show investors and sell-side analysts can exhibit excessive optimism by extrapolating past outperformance. We find that greater optimism for local stocks predicts financial advisor misconduct. When optimism for local stocks is higher, disappointing earnings and low stock returns follow, and the likelihood of misconduct is greater. Advisors in high-optimism localities are 23% more likely to be involved in a misconduct case the following year than those in less optimistic areas.

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We study the role that common behavioral biases play in financial advisor misconduct. The majority of U.S. investors have consulted with a financial advisor. Yet, unfortunately, financial advisor misconduct is not uncommon (Dimmock, Gerken, and Graham (2018), Egan, Matvos, and Seru (2019), and Dimmock, Gerken, and Graham (2020)). Seven percent of advisors have misconduct records. Each year in our sample, 0.76 percent of advisors have a misconduct case resolved against them. Misconduct is usually attributed to unethical behavior by advisors and their employers. We build on earlier research and ask whether common behavioral biases can also explain some financial advisor misconduct. Many misconduct cases involve investor complaints over "unsuitable investments" or "risky investments" and other actions that could reflect poor judgment rather than unethical behavior.

Our central hypothesis is that two well-documented behavioral biases, the local firm bias and the excessive optimism bias, can result in financial advisor misconduct. Retail investors and professional fund managers overweight local firms (Ivkovich and Weisbenner (2005), Seasholes and Zhu (2010), and Coval and Moskowitz (1999)). The typical U.S. household portfolio consists of 30% of local stocks compared to the 12% of total market capitalization that local stocks represent. Investors also overreact to persistent news, creating biases in expectations that impact stock prices and analysts' earnings forecasts. When investors' expectations about firms are highly optimistic, subsequent earnings disappoint, and stock returns are low. (e.g., Debondt and Thaler (1985 and 1987), La Porta (1996), and Bordalo, Gennaioli, La Porta, and Shleifer (2019 and 2023)). We hypothesize that greater optimism for local stocks can lead to financial adviser misconduct.

For example, consider two advisors located in different parts of the country. Assume each has a similar pool of clients regarding age, wealth, and risk tolerance. The two advisors put similar

clients into similar portfolios containing the same local stock exposure. The only difference is that there is an optimism bias for the local stocks of one advisor but not the other. We predict that the advisor located where there is an optimism bias in local companies is more likely to have a misconduct case in the following period, as the local companies are more likely to underperform, and the investors will blame the advisor for not foreseeing this. So even though the two advisors invested the same way for the same type of client, poor ex-post performance will result in one advisor having a misconduct complaint lodged against him, but not the other.

Furthermore, the two biases can interact. Continuing with the previous example, the advisor located near firms with an optimism bias may invest a greater share of clients' assets in local companies because the advisor, and perhaps the clients, have overly optimistic expectations for local companies. This would be consistent with research based on Canadian data showing that advisors exhibit behavioral biases in their own portfolios and that advisor's portfolios are similar to their client's portfolios (Foerster, Linnainmaa, Melzer, and Previtero (2017) and Linnainmaa, Melzer, and Previtero (2021)). Moreover, even if the advisor is unaffected by these biases, she may still overweight local stocks to cater to clients' beliefs (Gennaioli, Shleifer, and Vishny (2015).

Sell-side analysts may also play a role. La Porta (1996) and Bordalo, Gennaioli, La Porta, and Shleifer (2019 and 2023) show that higher analysts' long-run earnings growth forecasts are too optimistic. Many financial advisors work at firms that employ sell-side analysts who can considerably influence which stock advisors recommend to their clients (Bradley, Gerken, and Willams (2021)). Thus, when analysts are overly optimistic about local firms, financial advisors may be influenced and overweight them.

We study these issues using the financial advisor misconduct dataset also used in Egan, Matvos, and Seru (2019). It contains 2.2 million adviser-year observations in the United States from 2007 to 2020. Misconduct is any complaint that led to a regulatory, internal, civil, or customer-related investigation that was resolved against the advisor.

We measure optimism using analysts' five-year earnings growth forecasts and past stock five-year returns. These variables have been linked to excessive optimism and predict disappointing earnings and low stock returns (see Debondt and Thaler (1985 and 1987), La Porta (1996), and Bordalo, Gennaioli, La Porta, and Shleifer (2019 and 2023)). The underlying idea for both variables is that analysts and investors naively extrapolate past performance into the future. This causes overly optimistic expectations for companies that outperformed in the past, and disappointment follows.

To conduct our analyses, each year, we create a portfolio of stocks for each advisor comprising all the publicly traded companies within 250 miles of the advisor's workplace. We value-weight the portfolios so that the more salient companies, which local investors are more likely to be familiar with, receive more weight. For both optimism measures, we find that when local portfolio optimism is greater, the likelihood that an advisor has a misconduct complaint the following year is significantly higher. The effects are economically significant. Depending on the optimism measure, an advisor in a high-optimism locality is 11% to 23% more likely to have a misconduct case the following year than an advisor in a low-optimism locality.

We conduct several contemporaneous tests that further support the idea that financial advisor misconduct is related to investor optimism and eventual disappointment. Financial advisor misconduct is greater when the local portfolio firms have earnings below analysts'

forecasts, lower earnings announcement day returns, and lower yearly stock returns. Depending on the measure of performance, misconduct is 10% to 25% more likely in localities where local firms underperform as compared to localities where local firms outperform.

Our results introduce several new facts to the literature on financial advisors and financial decision-making. Our findings suggest that not all misconduct reflects unethical behavior on the advisor's part. This interpretation is consistent with Foerster, Linnainmaa, Melzer, and Previtero (2017) and Linnainmaa, Melzer, and Previtero (2021), who, using Canadian data, show that advisors make the same mistakes in their own accounts as they do in their clients' accounts.

Our findings suggest that the extent to which retail investors receive poor financial advice from advisors could be far greater than reflected in misconduct cases. In localities with no optimism bias, investors may still be overweighted in local stocks, but the stocks do not underperform, so the investors do not complain. These advisors still gave bad advice, but we do not observe it in our sample of misconduct cases triggered by client complaints.

Sell-side analyses may play a role in financial misconduct, as greater long-term growth forecasts for local stocks predict misconduct.[1] Many advisors work at firms that employ sell-side analysts. The findings in La Porta (1996), Bordalo, Gennaioli, La Porta, and Shleifer (2019 and 2023) show that sell-side analysts have an optimism bias and that investors who rely on their long-term growth forecasts suffer poor performance. Yet, in such cases, analysts are not accused of being unethical. Advisors may be following the analyst's advice when they invest their clients'

[1] Analysts also give stronger recommendations and higher price targets to overvalued stocks (Engelberg, McLean, and Pontiff (2020)). Analysts' earnings forecasts are upward biased for overvalued stocks (Engelberg, McLean, and Pontiff (2018). In contrast, analysts' revisions for recommendations and price targets predict returns in the intended direction and helpful to retail investors (McLean, Pontiff, and Reilly (2023)).

wealth into firms being promoted by the analysts. Consistent with this idea, Bradley, Gerken, and Willams (2021) show that local retail investors trade more in stocks covered by sell-side analysts associated with local brokerage offices.

Our paper builds on earlier studies on the determinants of financial advisor misconduct, which tend to attribute misconduct to unethical behavior on the advisor's part (Egan, Matvos, and Seru (2019), Dimmock, Gerken, and Van Elken (2018), Dimmock, Gerken, and Van Elken (2021), and Bai, Shang, Wan, and Zhao (2023)). Unethical behavior and behavioral biases are not mutually exclusive explanations, and although our findings suggest an important role for behavioral biases, they do not contradict the findings in these earlier studies. Rather, our findings build on these earlier studies by adding to our understanding of the causes of financial advisor misconduct.

Our study has policy implications. Regulations and internal controls at firms aimed at reducing misconduct caused by common behavioral biases will differ from those aimed at misconduct caused by unethical actions. The disciplinary actions and career prospects for an advisor affected by common behavioral biases ought to differ from those of an advisor who behaves unethically. Our findings and those in Bradley, Gerken, and Willams (2021) suggest brokerages need to understand better how sell-side analysts influence advisors and whether this influence is helpful.

1. Data, Sample, and Preliminaries

1.1 Misconduct Data

We collect data on financial advisor misconduct by scraping financial misconduct data from the Financial Industry Regulatory Authority's (FINRA) BrokerCheck database and the Investment Adviser Public Disclosure (IAPD) database. These databases include all financial advisers registered with FINRA and provide data on an adviser's employment history, qualifications, and disclosures, which include any misconduct allegations. Our final sample includes more than 1.4 million financial advisers. The databases place each adviser's disclosures into 23 categories, from criminal offenses to customer disputes. Following Egan et al. (2019), we consider a disclosure as misconduct if it falls into any of the following categories: Termination, Criminal, Financial, Judgment/Lien, Customer Dispute, Regulatory Event, Bond, Civil Event, or Investigation. We only count a dispute as financial advisor misconduct if it was resolved in favor of the client. Client disputes that are pending, withdrawn, or denied are not counted as misconduct. We provide summary statistics in Table 1.

Table 2 summarizes the misconduct data by the reason for the complaint. The most common category of misconduct in the Egan et al. data is "Unsuitable Investments" (21.3% of misconduct cases). Other common categories include "Misrepresentation" (17.7% of cases), "Omission of Key Facts" (11.6% of cases), and "Risky Investments" (3.7% of cases). Such cases could involve losses due to behavioral biases rather than unethical behavior. Some cases may be judgment calls rather than clear-cut mistakes by the advisor, as well-meaning, unbiased persons can have different opinions on what constitutes a suitable investment for a particular investor.

Other types of misconduct are less likely to stem from behavioral biases and more clearly reflect unethical behavior. The "Unauthorized Activity" (15% of cases), "Fraud" (6.5% of cases), and "Churning/Excessive Trading" categories more clearly reflect violations of rules.

The “Other” category in Table 2 comprises 42.5% of cases. It consists of all complaints that comprise less than 2% of the total. Some of these could reflect behavioral biases, whereas others may not.

1.2 Measures of Excessive Optimism

We use two measures of optimism: the long-term earnings growth forecast and past long-run stock returns. In earlier studies, both measures have been shown to predict disappointing financial performance and lower stock returns.

Analysts’ Long-Term Growth Forecast. Analysts, 5-year earnings growth rates have been linked to excessive optimism. Firms with higher expected growth rates fail to live up to these expectations and suffer abnormally low stock returns as a result. La Porta (1996) shows that stocks with higher long-term earnings growth forecasts, which are forecasted earnings growth over the next five years, have lower future stock returns. Bordalo, Gennaioli, La Porta, and Shleifer (2019) confirm La Porta’s findings out-of-sample and find that stocks with higher earnings growth forecasts had fast earnings growth, which slows down in the future, have upward biased earnings forecasts later revised downwards, and high past stock returns. Bordalo, Gennaioli, La Porta, and Shleifer (2021) find that aggregate growth forecasts can predict market returns.

Past Stock Returns. We use past stock returns measured over the past 3 and 5 years as a measure of optimism. De Bondt and Thaler (1985 and 1987) show that stocks with high returns over the past three and five years have low future stock returns and disappointing earnings relative to analysts’ forecasts. Past stock returns are perhaps the most salient metric of firm

performance. Thus, unsophisticated investors and their advisors may latch on to these when forming expectations.

1.3. Measures of Firm Performance

We use three different measures of firm performance. Two are related to analysts: the analyst earnings forecast error and the earnings announcement day return. The third measure is the yearly stock return. Summary statistics for these variables are provided in Table 1.

Analyst Forecast Error. We obtain analysts' earnings forecasts from IBES database. We use the median consensus annual earnings per share forecast closest in time to the earnings announcement date. Our results are robust if we use mean analysts' forecast. We measure analyst forecast error as the difference between the forecasted earnings per share and the actual earnings per share, all scaled by the stock price at the fiscal year-end. A higher forecast error is associated with greater analyst optimism and greater investor disappointment.

Earnings Announcement Day Returns. Earnings announcement returns are daily stock returns minus the value-weighted market index returns from CRSP. Earnings announcement dates are obtained from IBES. We calculated cumulative abnormal returns over the three days before and three days after the announcement day.

Yearly Stock Returns. We measure annual stock returns over the same year as the year of misconduct. Our results remain the same when we use yearly returns or the year before the misconduct.

1.4 Control Variables

Our regressions include control variables measured at the advisor-level, the brokerage-level, and the county-level.

Brokerage characteristics. The brokerage traits that we control for include the number of affiliated advisors and the number of brokers with misconduct cases over the last three years.

Advisor Characteristics. For advisor characteristics, we include a dummy variable indicating whether the advisor has a misconduct in the past three years, dummy variables for advisors who have passed the respective qualification examinations, including the Series 63 (Uniform Securities Agent State law), Series 65 (Uniform Investment Advisor Law), and Series 66 (Uniform Combined Law). We also include two demographic variables. Female is a dummy variable equal to 1 if the advisor is female. White is a dummy variable equal to 1 if the advisor is Caucasian.

County Characteristics. At the county level, we include the county's average household income (County_Income), the percentage of the county population that has completed at least secondary education (County_Education), and County_GDP. These data are from U.S. census 2010.

1.5 Preliminary Findings

Table 3 reports some preliminary findings. We estimate five regressions: one for each of our two optimism variables and one for each of our three performance variables. For each variable, we measure the value-weighted average for a portfolio of stocks comprising all firms headquartered within 250 miles of the advisor's workplace. The unit of observation is at the advisor-year level, and the regressions are linear probability models. The dependent variable

equals one if the advisor has a financial misconduct case and zero otherwise. The regressions include year, state, and brokerage fixed effects but nothing else. We add more control variables in the later tables. The standard errors are clustered on county and year.

Regressions 1 and 2 use the optimism variables: analysts' long-term earnings growth forecast and past five-year stock return. We regress misconduct measured in year *t* on optimism measured in year *t-1*. The regressions ask: When optimism is higher for local firms, is the likelihood of misconduct higher over the next year? In both regressions, the coefficients are positive and highly significant, showing that greater optimism for local firms predicts advisor misconduct.

Regressions 3-5 use the three performance variables: analysts' forecast error, yearly stock returns, and earnings announcement returns. As with the optimism variables, for each performance variable, we measure the value-weighted average of the variable for a portfolio of stocks comprising all firms headquartered within 250 miles of the advisor's workplace. We test for a contemporaneous relation by regressing misconduct measured in year *t* on performance measured in year *t*. The regressions ask: When local firms disappoint, is the likelihood of misconduct higher? All three regressions show that this is the case. The coefficients for the yearly stock return and earnings announcement return are negative, showing that worse performance increases the likelihood of misconduct. The coefficient for the analysts' forecast error (analysts' forecast – actual earnings) is positive and significant, meaning that when firms report earnings less than expected, misconduct is more likely.

2. Predicting Financial Misconduct

Tables 4 and 5 report our findings for local firm optimism and the subsequent likelihood of misconduct. We use analysts' long-term earnings growth forecasts and past long-run stock returns as proxies for optimism. The regressions test whether these variables portend a greater likelihood of financial advisor misconduct.

2.1. Analysts' Long-Term Growth Forecast and Misconduct

In Table 4, the dependent variable is a dummy variable equal to 1 if a misconduct case is resolved against the advisor in year *t*, and zero otherwise. The primary independent variable of interest is the value-weighted average long-term growth forecast for a portfolio of stocks comprising all firms headquartered within 250 miles of the advisor's workplace. The regressions have year, state, and brokerage fixed effects. The standard errors are clustered on county and year.

The results show that when analysts are more optimistic about the growth of local firms, misconduct is more likely in the following year. Regression 1 has fixed effects but no other controls. The coefficient is 0.014 (*t*-statistic =3.58). In the next two regressions, we add various controls, and the effect of the long-term growth forecast is virtually unchanged. Regression 2 adds county-level controls, including income, education, and lagged GDP growth. Regression 3 includes the county-level controls and adds brokerage-level and advisor-level controls. Although several of these control variables have highly significant effects, they do not explain the effect of the long-term growth forecast, which has a coefficient of 0.013 in both regressions and *t*-statistics over 3 in both regressions.

Using the summary statistics reported in Table 1, a regression coefficient of 0.013 shows that a one-standard deviation increase in the long-term growth forecast yields an increase of 0.04 percent in the likelihood of misconduct. Misconduct has an unconditional probability of 0.76 percent. We can define a high (low) optimism portfolio as one with a long-term growth forecast one standard deviation above (below) the mean. An advisor in a low-optimism locality has a 0.72 percent likelihood of misconduct, while one in an optimistic locality has a 0.80 percent likelihood of misconduct, which is 11% greater.

The coefficients for the control variables point to other significant factors. As found in Egan. et al. (2019), misconduct is more likely in wealthier counties and counties where the residents are less educated. Some advisors tend to be repeat offenders, as misconduct is more likely for advisors who have had misconduct in the past three years, which is also consistent with Egan et al. (2019). Advisors at larger brokerage firms, as measured by assets under management, are less likely to have misconduct. At the advisor level, misconduct is less likely for women but more likely for advisors who passed their Series 65 exam, which licenses an advisor to give financial advice.

Regressions 4 and 5 are for robustness. We compute the portfolio returns for firms within 100 miles of the advisor's office in regression 4 and 500 miles in regression 5. There is a tradeoff with using wider or narrower ranges. With wider ranges, the portfolios have more firms and will be less noisy. This is especially true for firms headquartered in more rural areas. With narrower ranges, the portfolios are better focused on nearby firms that local investors pay more attention to. That all stated, we get significant effects with the 100-mile and 500-mile range portfolios. Compared to 250 miles, the effects of the 500-mile portfolio are slightly stronger, and those of

the 100-mile portfolio are slightly weaker. The convention in the literature is to use 250 miles, so we focus on those findings.

Regression 6 returns to the 250-mile portfolio but equal weights the firms. We expect weaker effects with this approach because local investors will be more familiar with and more likely to invest in larger local companies. Put differently, we believe that the larger local companies drive the results. Consistent with this idea, we find that the coefficient for the equal-weighted portfolio is positive but insignificant.

2.2. Past Stock Returns and Misconduct

Table 5 uses past stock returns measured over the last five years as the measure of optimism. It shows that past returns are a powerful predictor of misconduct. As we mentioned earlier, past stock returns are highly salient and thus likely to be the focus of less sophisticated investors and their advisors. Misconduct is measured in year *t*, while past return measurement begins five years before year *t* and ends on the final day of year *t-1*.

The first three regressions in Table 5 have just the portfolio returns with fixed effects (regression 1), the portfolio returns with fixed effects and county-level controls (regression 2), and the portfolio returns with fixed effects, county-level controls, brokerage-level controls, and advisor-level controls (regression 3). In all three regressions, the effects of past returns on misconduct are highly significant. There is virtually no variation in the coefficients and *t*-statics for the past return variable across the three regressions, showing that its effect is independent of the effects captured by the control variables.

In regression 3, which has the most complete set of controls, the past return coefficient is 0.312 (*t*-statistic = 5.02). The standard deviation of the 5-year past return variable is 0.2478, so a one standard deviation increase (decrease) yields a 0.077 percent increase (decrease) in the likelihood of misconduct. As mentioned earlier, the unconditional mean of misconduct is 0.76 percent. Thus, an advisor in a locality with a low past return has a 0.683 percent likelihood of misconduct in the following year. In comparison, one in a high past return locality has a 0.83 percent chance of misconduct, which is 23% higher.

Regression 4 is like regression 3, only we examine past 3-year returns instead of past 5-year returns. The results are similar; the coefficient is 0.531 (t-statistic = 5.02). A one standard deviation increase in past return yields a 0.099% increase in the likelihood of misconduct, an increase of 13% relative to the mean.

Regressions 5 and 6 return to the 5-year past return variable and vary the locality to 100 miles (regression 5) and 500 miles (regression 6). In both cases, the effects of past returns remain positive and significant. As in Table 3, the 100-mile portfolio seems to have nosier returns as it contains fewer firms, but its *t*-statistic is still 2.08.

Regression 7 reports the results for the equal-weighted past return portfolio. As explained earlier, we expect weaker results with this measure as the local firm bias ought to be strongest with larger, more visible firms. Consistent with this idea, the past return coefficient in this regression is insignificant.

3. Local Firms' Performance and Financial Misconduct

Whereas the regressions discussed previously used measures of optimism to forecast misconduct, we now study the effects of the resulting disappointment on misconduct. Tables 5, 6, and 7 report findings on the relation between local firms' performance and financial advisor misconduct. Firm performance is measured using analyst forecast error, stock returns on and around earnings announcement days, and the annual stock return. These regressions ask, are advisors more likely to have misconduct when local firms have disappointing performance?

Both misconduct and firm performance are measured in year *t*. This assumes that misconduct complaints are filed and resolved in the year of the disappointment. We, therefore, will miss misconduct complaints filed toward the end of the year, which, if anything, makes it more difficult for us to get significant findings. Two of our measures, though, the analyst forecast error and the earnings announcement return, are far more common early in the calendar year, as this is when most firms report their earnings for the previous fiscal year, and we only consider annual earnings announcements. If a firm announces its earnings after July 1, we move it one year ahead.

3.1. Analyst Forecast Error and Misconduct

We report the findings for the analyst forecast error in Table 6. A positive forecast error means the forecast was higher than the actual earnings, so a higher forecast error means more past optimism and greater disappointment. As in the previous tables, the first three regressions report results with various controls. The controls matter little, and the three regressions consistently show that advisors located around firms with higher forecast errors are more likely to have misconduct.

In regression 3, the most complete specification, the coefficient is 16.824 (*t*-statistic =-3.56). Taken together with the summary statistics in Table 1, we can say that an advisor in a high forecast error (one standard deviation increase) locality has a 7.3% greater chance of misconduct than an advisor in a low forecast error (one standard deviation increase) locality.

Regressions 4 and 5 report results for local portfolios comprised of firms within 100-mile and 500-mile radiuses, respectively. The results are unchanged: In both cases, greater forecast error or disappointing earnings are associated with an increased likelihood of misconduct. Regression 6 reports the results with equal-weighted forecast error. It is significant and similar to the results for the value-weighted portfolios.

3.2. Earnings Announcement Returns and Misconduct

Table 7 uses earnings announcement returns as the performance variable. To measure the announcement returns, we cumulate the daily stock returns over a seven-day window, comprised of the earnings announcement day, the three preceding days, and the three following days.

The regressions in Table 7 follow a similar format to those of the earlier tables. Regressions 1-3 use the value-weighted announcement returns for firms headquartered within 250 miles of the advisor. The regressions use various controls, with regression 3 having the most complete set of controls. The results show that advisors located in regions where local firms announced disappointing earnings are more likely to have misconduct cases. As with the previous tables, the controls have little impact on the primary variable. The coefficients and *t*-statistics for the announcement returns are similar across the three regressions.

In regression 3, the specification with the most controls, the coefficient is -1.032 (t-statistic = -3.11). Although it is statistically significant, the economic significance is small. The standard deviation of the earnings announcement variable is 0.0153. The difference between a high and low disappointment locality based on one standard deviation above or below the mean is only about 2.3%. Firms, of course, report more news over the course of the year than is contained in just annual announcements. In the next table, we examine stock returns, and the economic significance is much larger.

Regressions 4 and 5 use local portfolios of firms within 100 miles or 500 miles of the advisor. In both cases, the coefficient is negative but not statistically significant. Regression 6 returns to the 250-mile range but uses a window of 5 days before and five days after the earnings announcement. The effects are highly significant and show that more disappointing earnings result in a higher likelihood of misconduct. The final regression also uses the 250-mile range, but equal-weights the firms. The negative and significant coefficient shows that greater disappointment makes misconduct more likely.

3.3. Stock Returns and Misconduct

Our final performance measure is the most important: stock returns. We measure yearly stock returns and test whether misconduct in year *t* is more common when year *t* stock returns are lower. As we mentioned earlier, there are issues with the timing here. If misconduct occurs toward year *t*'s end, it is unlikely to be resolved in year *t* and thus missing from our data. To address this, we also ask whether misconduct in year *t* is greater if stock returns in year *t-1* are lower.

The results in Table 8 show that misconduct is far more likely in localities where local companies have lower stock returns than in localities with higher stock returns. In regression 3, the most complete specification in terms of controls, the coefficient is -0.420 (t-statistic = -3.83). The standard deviation of the return variable is 0.220. The unconditional mean of the misconduct variable is 0.76 percent, so an advisor in a locality with a portfolio return one standard deviation below the mean has a 0.85 percent probability of misconduct, whereas an advisor in a locality with a portfolio return one standard deviation above the mean has a 0.67 percent probability of misconduct. Thus, there is a 28 percent difference in likelihood between a high and low-return locality, a sizeable effect.

Regressions 4 and 5 estimate the effects using portfolios of local firms located within 100 miles and 500 miles of the advisor. In both regressions, the coefficients are negative and highly significant. The effects are stronger in magnitude and significance for the 500-mile portfolio, which makes sense as it has more firms and should be less noisy.

Regression 6 uses the stock return measured in year *t-1* instead of the contemporaneous stock return as in the other regressions. It should capture misconduct complaints resolved in year *t*, but associated with poor performance in year *t-1*. The results are similar to those of regression 3, which is the same estimation but uses the contemporaneous return, although the magnitude and significance of the return coefficient in regression 6 is smaller.

Regression 7 returns to the contemporaneous portfolio returns but equal-weights the portfolio, as opposed to value-weighting, which is used in the other regressions. Here, the return coefficient is negative but not significant. We expect investors to overweight the largest and most

visible local firms, so the fact that we do not have significant returns with equal-weighted portfolios is not surprising.

4. Robustness

In this section, we provide some additional robustness tests. For each advisor-year observation, we compute the value-weighted average for each local firm portfolio as we did before, but now we also subtract from that the value-weighted average of the non-local firm portfolio. These tests focus more closely on how cross-sectional differences in optimism and performance impact the likelihood of misconduct.

Table 9 reports five specifications, one for the two optimism variables and one for each of the three performance variables. The first two regressions use the analysts' five-year earnings growth forecasts (regression 1) and past five-year stock returns (regression 2). In both regressions, the optimism variables are positive and highly significant, confirming the results in the earlier tables, which show that greater optimism for local firms increases the likelihood of financial advisor misconduct in the following year.

Regressions 4-6 study the performance variables, which include the analysts' forecast error (regression 4), the contemporaneous stock return (regression 5), and the cumulative abnormal returns for a 3-day window around and on the annual earnings announcement (regression 6). The coefficients show that greater investor disappointment increases the likelihood of misconduct in all three cases. The coefficient for the analysts' forecast error (forecasted earnings minus actual earnings) is positive and significant, while the coefficients for the yearly stock return and the earnings announcement returns are negative and significant.

Taken in their entirety, the results in Table 9 confirm the findings in earlier tables. Financial advisor misconduct is more likely to follow when there is greater optimism for local firms and when local firms perform poorly as compared to nonlocal firms.

5. Conclusion

Two well-documented biases, the local firm bias, and the excessive optimism bias, can combine to create financial advisor misconduct. It is well-documented that investors overweight local firms and likely do so more when investors and analysts are optimistic about local firms. Thus, precisely when investors should avoid local firms, they may overweight them the most. Poor performance in local firms then follows, and investors may blame their advisors. Consistent with this narrative, high optimism for local firms predicts financial advisor misconduct. Misconduct is also more likely when local firms report disappointing earnings and low stock returns. These findings suggest that some financial misconduct cases are better explained by behavioral biases on the part of advisors, and perhaps also their clients and sell-side analysts, rather than unethical behavior on the advisor's part.

One reason our findings are important is that firms and regulators must know what causes misconduct if they want to reduce it. Strategies for limiting misconduct due to unethical behavior will differ from those aimed at limiting misconduct due to behavioral biases. The former probably involves screening out bad apples, whereas the latter may involve better training and education.

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Table 1: Summary Statistics

This table reports summary statistics for the variables in our analyses. EPSgrwd_250m is the average long-term earnings growth forecast by sell-side analysts for a value-weighted portfolio of firms within a 250-mile radius of the advisor's workplace. Similarly, EPSgrwd_100m and EPSgrwd_500m are for portfolios of firms within a 100-mile and 500-mile radius of the advisor's workplace, respectively. EPSgr_250m is constructed similarly to EPSgrwd_250m, except the portfolio is equal-weighted instead of value-weighted. Diff_EPSgrwd_250m is the difference between the local portfolio (within a 250-mile radius) and a portfolio of all firms outside the radius. RET5ywd_250m (RET5ywd_100m and RET5ywd_500m) is the value-weighted past five years stock returns for the portfolios of firms within the 250 miles (100 miles, 500 miles) of the advisor's workplace. RET5y_250m is the equally weighted past five year return for the portfolio of firms within the 250-mile radius of the advisor's workplace. Diff_Ret5ywd_250m is the difference between the local portfolio RET5ywd_250m and a portfolio of the non-local firms' past five years' returns. AFE_Medwd_250m is the value-weighted portfolio median consensus analyst earnings forecast error among firms within a 250-mile radius of the advisor's workplace. Similarly, AFE_Medwd_100m and AFE_Medwd_500m are for the portfolios of firms within 100 miles and 500 miles radius of the advisor's workplace, respectively. AFE_Med_250m is defined similarly to AFE_Medwd_250m, except the portfolio is equally weighted instead of value-weighted. Diff_AFE_Medwd_250m is the difference between the forecast error of the local portfolio (within a 250-mile radius) and the rest of the firms that are outside the radius. RET0wd_250m (RET0wd_100m and RET0wd_500m) is the value-weighted average annual stock return for the portfolios of firms within the 250 miles (100 miles, 500 miles) radius from the advisor's workplace. RET0_250m is the equally weighted average annual stock return for the portfolio of firms within a 250-mile radius of the advisor's workplace. Diff_Ret0wd_250m is the difference between RET0wd_250m and the value-weighted average of the non-local firms' annual stock returns. EACAR33wd_250m (EACAR33wd_100m and EACAR33wd_500m) is the weighted cumulated abnormal returns from three days before through three days after the earnings announcement day for the portfolio of firms headquartered within 250 miles (100 miles and 500 miles) radius from the advisor's workplace. EACAR33_250 is defined similarly as EACAR33wd_250m except it is equal-weighted. Diff_EACAR33wd_250m is the difference between EACAR33wd_250m and the value-weighted announcement returns for the firms outside of the 250-mile radius. Misconduct is a binary variable equal to 1 if the advisor has a misconduct case in the current year. Misconduct(last 3y) is a dummy variable indicating whether the advisor has a misconduct in the past three years. Broker size is total number of the advisors affiliated with the broker firm. % of brokers_misconduct is the percent of advisors with misconduct over the past three years at the brokerage firm. Series63, Series65, Series66, are dummy variables for advisors who have passed the respective qualification examinations at the time of the observations. Series63 is for Uniform Securities Agent State law, Series65 is for Uniform Investment Advisor Law, and Series66 is for Uniform Combined Law. The two demographic variables of financial advisors are, Female which is a dummy variable equal to 1 if the advisor is female, and White which is a dummy variable equal to 1 if the advisor is Caucasian. County_Income is the average household income. County_Education the percentage of the county population that has completed at least secondary education. County_GDP is per capita GDP. These county-level data are from U.S. census 2010.

Table 1 (Continued)

	N	Mean	SD	p25	Median	p75
EPSgrwd_250m	12,299,076	12.4961	2.9286	10.6831	11.9479	13.5569
EPSgrwd_100m	12,299,076	12.3095	3.5538	10.3154	11.782	13.9541
EPSgrwd_500m	12,299,076	12.4346	2.5832	10.6651	11.8993	13.4912
EPSgr_250m	12,299,076	15.262	2.9078	13.3857	14.6286	16.6811
Diff_EPSgrwd_250m	12,299,076	-0.6384	2.6541	-2.0345	-0.9596	-0.0144
RET5ywd_250m	12,299,076	0.6914	0.2478	0.5144	0.6826	0.8074
RET5ywd_100m	12,299,076	0.6894	0.3278	0.5157	0.6825	0.8233
RET5ywd_500m	12,299,076	0.6905	0.2465	0.5265	0.6719	0.7819
RET5y_250m	12,299,076	0.492	0.2895	0.2866	0.511	0.7145
Diff_RET5ywd_250m	12,299,076	-0.0335	0.1768	-0.1405	-0.0161	0.043
AFE_medwd_250m	12,299,076	0.0001	0.0016	-0.0006	-0.0003	0.0001
AFE_medwd_100m	12,299,076	0	0.0022	-0.0006	-0.0003	0.0001
AFE_medwd_500m	12,299,076	0.0001	0.0014	-0.0005	-0.0003	0.0001
AFE_med_250m	12,299,076	0.0041	0.0099	-0.0005	0.0009	0.0039
Diff_AFE_medwd_250m	12,299,076	0.0001	0.0013	-0.0003	0	0.0004
RET0wd_250m	12,299,076	0.0946	0.22	-0.052	0.1395	0.2338
RET0wd_100m	12,299,076	0.0943	0.2247	-0.0534	0.1235	0.2395
RET0wd_500m	12,299,076	0.0957	0.2147	-0.0478	0.1452	0.227
RET0_250m	12,299,076	0.1688	0.1662	0.0686	0.1881	0.2714
Diff_RET0wd_250m	12,299,076	0.0001	0.0581	-0.0286	0.003	0.0282
EACAR33wd_250m	12,299,076	0.0041	0.0153	-0.0032	0.0041	0.0116
EACAR33wd_100m	12,299,076	0.0041	0.023	-0.0053	0.0025	0.0143
EACAR33wd_500m	12,299,076	0.0039	0.0106	-0.0017	0.0035	0.009
EACAR33_250m	12,299,076	0.0054	0.0122	-0.0005	0.0062	0.0126
Diff_EACAR33wd_250m	12,299,076					
Misconduct	12,299,076	0.0076	0.0868	0	0	0
Misconduct(last 3y)	12,299,076	0.0179	0.1324	0	0	0
Broker Size	12,299,076	1.9642	0.7735	1.3863	2.0794	2.5649
Series63	12,299,076	0.7075	0.4549	0	1	1
Series65	12,299,076	0.239	0.4265	0	0	0
Series66	12,299,076	0.2266	0.4187	0	0	0
Female	12,299,076	0.2505	0.4333	0	0	1
White	12,299,076	0.8661	0.3406	1	1	1
% of brokers_misconduct	12,299,076	0.0205	0.0216	0.0029	0.0149	0.0311
County_Income	12,299,076	11.2399	0.2805	11.0366	11.2315	11.3728
County_Education	12,299,076	0.3948	0.1267	0.3082	0.3742	0.4887
County_GDP	12,299,076	40588.504	5691.7313	36028.755	40960.829	45473.443

Table 2: The Different Types of Misconduct

This table reports the percent of misconduct cases by misconduct category. Other is the aggregate of various types of misconduct that are less than 2% of the total misconduct cases.

Reasons for Complaint	% Misconduct
Unsuitable	21.3%
Misrepresentation	17.7%
Unauthorized Activity	15%
Omission of Key Facts	11.6%
Fee/Commission Fraud	8.7%
Fraud	7.9%
Fiduciary Duty	6.5%
Negligence	5.8%
Risky Investment	3.7%
Churning/Excessive Trading	2.6%
Other	42.5%

Table 3: Univariate Regressions

This table reports the results from linear probability regressions. The dependent variable equals one if the advisor has a misconduct case resolved against them in year *t* and zero otherwise. The unit of observation is advisor-year. Each predictor variable is a value-weighted portfolio consisting of the value-weighted average of the variable for a portfolio of firms within 250 miles of the advisor's office. *EPSgrwd* is the analysts' forecast of EPS growth over the next five years. *LagRET5ywd* is the past 5-year stock return. *EPSgrwd* and *LagRET5ywd* are measured at the end of year *t-1*. *AFEwd* is the analysts' forecast error for the previous year's earnings, reported in year *t*. *RET0ywd* is the stock return in year *t*. *EACARwd* is the earnings announcement return for the previous year's earnings, reported in year *t*. The regressions include year, state and brokerage fixed effects The standard errors are clustered on year and county.

	Optimism Variables		***Performance Variables***		
Indep. Variables	*EPSgrwd*	*LagRET5ywd*	*AFEwd*	*RET0ywd*	*EACARwd*
Coefficient	0.014***	0.362***	17.721***	-0.477***	-1.199***
	(3.58)	(5.36)	(3.52)	(-3.93)	(-3.38)
Year	Yes	Yes	Yes	Yes	Yes
State	Yes	Yes	Yes	Yes	Yes
Broker Firm	Yes	Yes	Yes	Yes	Yes
# of Observations	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015

Table 4: Long-Term Earnings Growth Forecasts and Broker Misconduct

This table reports the results from linear probability regressions. The dependent variable equals one if the advisor has a misconduct case resolved against them in year *t* and zero otherwise. The unit of observation is advisor-year. *EPSgrwd_250m* is based on sell-side analysts' forecast of EPS growth over the next five years. It is the value-weighted average of the forecasted EPS growth for a portfolio of firms within 250 miles of the advisor's office. *EPSgrwd_100m (EPSgrwd_500m)* are the same but for firms within 100 miles (500 miles) of the advisor's office. *EPSgr_250m* equal-weights the firms. The control variables are defined in Table 1. The regressions include year, state, and brokerage fixed effects. The standard errors are clustered on year and county.

	1	2	3	4	5	6
EPSgrwd_250m	0.014***	0.013***	0.013***			
	(3.58)	(3.47)	(3.57)			
EPSgrwd_100m				0.005**		
				(2.01)		
EPSgrwd_500m					0.023***	
					(3.66)	
EPSgr_250m						0.009
						(1.52)
County_income		0.754***	0.626***	0.628***	0.618***	0.628***
		(4.82)	(4.86)	(4.90)	(4.81)	(4.87)
County_Education		-1.660***	-1.456***	-1.467***	-1.429***	-1.461***
		(-5.34)	(-5.83)	(-5.90)	(-5.76)	(-5.87)
County_GDP		0.000**	0.000**	0.000**	0.000***	0.000**
		(2.33)	(2.35)	(2.36)	(2.79)	(2.46)
% brokers_misconduct			-0.330	-0.321	-0.339	-0.319
			(-0.68)	(-0.67)	(-0.71)	(-0.66)
Misconduct(last 3y)			5.065***	5.065***	5.064***	5.065***
			(34.60)	(34.60)	(34.61)	(34.59)
Broker Size			-0.113***	-0.113***	-0.113***	-0.113***
			(-13.68)	(-13.69)	(-13.65)	(-13.69)
Series63			-0.020	-0.021	-0.021	-0.021
			(-1.46)	(-1.47)	(-1.47)	(-1.47)
Series65			0.544***	0.544***	0.544***	0.544***
			(11.76)	(11.75)	(11.75)	(11.76)
Series66			-0.032	-0.033	-0.033	-0.033
			(-1.03)	(-1.03)	(-1.04)	(-1.04)
Female			-0.389***	-0.389***	-0.389***	-0.389***
			(-11.72)	(-11.72)	(-11.72)	(-11.72)
White			0.003	0.003	0.003	0.003
			(0.36)	(0.35)	(0.36)	(0.35)
Year	Yes	Yes	Yes	Yes	Yes	Yes
State	Yes	Yes	Yes	Yes	Yes	Yes
Brokerage Firm	Yes	Yes	Yes	Yes	Yes	Yes
# of Observations	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015
adjR2	0.009	0.009	0.016	0.016	0.016	0.016

Table 5: Past 5-Year Stock Returns and Broker Misconduct

This table reports the results from linear probability regressions. The dependent variable equals one if the advisor has a misconduct case resolved against them in year t and zero otherwise. The unit of observation is advisor-year. *RET5yrwd_250m* is based on the past 5 years' stock return. It is the value-weighted average of the past 5 years stock returns for a portfolio of firms within 250 miles of the advisor's office. *RET5yrwd_100m (RET5yrwd_500m)* are the same but for firms within 100 miles (500 miles) of the advisor's office. *RET5y_250m* equal-weights the firms. The control variables are defined in Table 1. The regressions include year, state, and brokerage fixed effects. The standard errors are clustered on year and county.

	1	2	3	4	5	6	7
RET5ywd_250m	0.360***	0.362***	0.312***				
	(5.25)	(5.36)	(5.02)				
RET3ywd_250m				0.531***			
				(5.02)			
RET5ywd_100m					0.067**		
					(2.08)		
RET5ywd_500m						0.310***	
						(3.31)	
RET5y_250m							-0.077
							(-1.21)
County_income		0.762***	0.632***	0.628***	0.630***	0.623***	0.621***
		(4.95)	(5.02)	(5.06)	(4.95)	(4.98)	(4.86)
County_Education		-1.666***	-1.460***	-1.454***	-1.461***	-1.439***	-1.446***
		(-5.40)	(-5.91)	(-5.94)	(-5.90)	(-5.88)	(-5.82)
County_GDP		0.000**	0.000**	0.000**	0.000**	0.000***	0.000**
		(2.40)	(2.43)	(2.45)	(2.40)	(2.77)	(2.40)
%brokers_misconduct			-0.419	-0.391	-0.347	-0.364	-0.323
			(-0.87)	(-0.81)	(-0.72)	(-0.76)	(-0.67)
Misconduct(last 3y)			5.063***	5.063***	5.065***	5.063***	5.065***
			(34.58)	(34.67)	(34.61)	(34.60)	(34.60)
Broker Size			-0.113***	-0.113***	-0.113***	-0.113***	-0.113***
			(-13.61)	(-13.59)	(-13.72)	(-13.69)	(-13.78)
Series63			-0.020	-0.020	-0.021	-0.020	-0.021
			(-1.41)	(-1.40)	(-1.47)	(-1.41)	(-1.48)
Series65			0.544***	0.544***	0.544***	0.543***	0.544***
			(11.74)	(11.74)	(11.75)	(11.73)	(11.74)
Series66			-0.032	-0.032	-0.033	-0.032	-0.033
			(-1.02)	(-1.00)	(-1.03)	(-1.01)	(-1.03)
Female			-0.389***	-0.389***	-0.389***	-0.389***	-0.389***
			(-11.73)	(-11.73)	(-11.72)	(-11.72)	(-11.71)
White			0.003	0.003	0.003	0.003	0.003
			(0.36)	(0.36)	(0.36)	(0.36)	(0.35)
Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes
State	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Brokerage Firm	Yes	Yes	Yes	Yes	Yes	Yes	Yes
# of Observations	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015
adjR2	0.009	0.009	0.016	0.016	0.016	0.016	0.016

Table 6: Analyst Forecast Error and Broker Misconduct

This table reports the results from linear probability regressions. The dependent variable equals one if the advisor has a misconduct case resolved against them in year t and zero otherwise. The unit of observation is advisor-year. *AFE_medwd_250m* is based on analyst earnings forecast error for year's *t-1* earnings forecast scaled by firms' stock price. It is the value-weighted average of analyst forecast errors for a portfolio of firms within 250 miles of the advisor's office. The forecast errors are *AFE_medwd_100m (AFE_medwd_500m)* are the same but for firms within 100 miles (500 miles) of the advisor's office. *AFE_med_250m* equal-weights the firms. The control variables are defined in Table 1. The regressions include year, state, and brokerage fixed effects. The standard errors are clustered on year and county.

	1	2	3	4	5	6
AFE_medwd_250m	17.721***	15.772***	16.824***			
	(3.52)	(3.22)	(3.56)			
AFE_medwd_100m				11.812***		
				(3.23)		
AFE_medwd_500m					19.783**	
					(2.48)	
AFE_med_250m						2.233***
						(2.77)
County_income		0.746***	0.618***	0.612***	0.621***	0.621***
		(4.80)	(4.84)	(4.85)	(4.84)	(4.86)
County_Education		-1.645***	-1.440***	-1.423***	-1.445***	-1.442***
		(-5.31)	(-5.80)	(-5.76)	(-5.81)	(-5.81)
County_GDP		0.000**	0.000**	0.000**	0.000**	0.000**
		(2.41)	(2.44)	(2.57)	(2.43)	(2.47)
% brokers_misconduct			-0.307	-0.303	-0.300	-0.316
			(-0.64)	(-0.63)	(-0.62)	(-0.66)
Misconduct(last 3y)			5.065***	5.065***	5.065***	5.065***
			(34.59)	(34.60)	(34.59)	(34.59)
Broker Size			-0.113***	-0.113***	-0.113***	-0.113***
			(-13.82)	(-13.77)	(-13.78)	(-13.81)
Series63			-0.021	-0.021	-0.021	-0.021
			(-1.49)	(-1.49)	(-1.48)	(-1.48)
Series65			0.544***	0.544***	0.544***	0.544***
			(11.74)	(11.75)	(11.75)	(11.74)
Series66			-0.032	-0.033	-0.033	-0.032
			(-1.02)	(-1.03)	(-1.03)	(-1.02)
Female			-0.389***	-0.389***	-0.389***	-0.389***
			(-11.72)	(-11.72)	(-11.72)	(-11.72)
White			0.003	0.003	0.003	0.003
			(0.35)	(0.35)	(0.35)	(0.35)
Year	Yes	Yes	Yes	Yes	Yes	Yes
State	Yes	Yes	Yes	Yes	Yes	Yes
Brokerage Firm	Yes	Yes	Yes	Yes	Yes	Yes
# of Observations	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015
adjR2	0.009	0.009	0.016	0.016	0.016	0.016

Table 7: Earning Announcement Returns and Broker Misconduct

This table reports the results from linear probability regressions. The dependent variable equals one if the advisor has a misconduct case resolved against them in year t and zero otherwise. The unit of observation is advisor-year. *EA_CAR33wd_250m* is based on the cumulative abnormal returns around the earnings announcement day (3 days before to 3 days after) for year *t-1* earnings. It is a value-weighted portfolio consisting of the value-weighted average of earnings announcement returns for a portfolio of firms within 250 miles of the advisor's office. *EA_CAR33wd_100m (EA_CAR33wd_500m)* are the same but for firms within 100 miles (500 miles) of the advisor's office. *EA_CAR33_250m* equal-weights the firms. EA_CAR55wd_250m is defined similarly as EA_CAR33wd_250m except that the CARs are calculated over 5 days before to 5 days after the earnings announcement date. The control variables are defined in Table 1. The regressions include year, state, and brokerage fixed effects. The standard errors are clustered on year and county.

	1	2	3	4	5	6	7
EA_CAR33wd_250m	-1.199***	-1.109***	-1.032***				
	(-3.38)	(-3.17)	(-3.11)				
EA_CAR33wd_100m				-0.209			
				(-0.99)			
EA_CAR33wd_500m					-0.095		
					(-0.18)		
EA_CAR33_250m						0.309	
						(0.53)	
EA_CAR55wd_250m							-0.892***
							(-3.36)
County_income		0.752***	0.624***	0.625***	0.626***	0.625***	0.624***
		(4.83)	(4.88)	(4.87)	(4.88)	(4.89)	(4.88)
County_Education		-1.656***	-1.452***	-1.452***	-1.452***	-1.451***	-1.451***
		(-5.35)	(-5.84)	(-5.84)	(-5.85)	(-5.85)	(-5.85)
County_GDP		0.000**	0.000**	0.000**	0.000**	0.000**	0.000**
		(2.34)	(2.37)	(2.42)	(2.45)	(2.43)	(2.36)
%brokers_misconduct			-0.340	-0.323	-0.318	-0.316	-0.338
			(-0.71)	(-0.67)	(-0.66)	(-0.66)	(-0.71)
Misconduct(last 3y)			5.065***	5.065***	5.065***	5.065***	5.065***
			(34.60)	(34.60)	(34.60)	(34.60)	(34.60)
Broker Size			-0.113***	-0.113***	-0.113***	-0.113***	-0.113***
			(-13.80)	(-13.76)	(-13.77)	(-13.76)	(-13.81)
Series63			-0.021	-0.021	-0.021	-0.021	-0.021
			(-1.48)	(-1.48)	(-1.48)	(-1.48)	(-1.48)
Series65			0.544***	0.544***	0.544***	0.544***	0.544***
			(11.75)	(11.75)	(11.75)	(11.75)	(11.74)
Series66			-0.033	-0.033	-0.033	-0.033	-0.033
			(-1.03)	(-1.03)	(-1.03)	(-1.03)	(-1.03)
Female			-0.389***	-0.389***	-0.389***	-0.389***	-0.389***
			(-11.72)	(-11.72)	(-11.72)	(-11.72)	(-11.71)
White			0.003	0.003	0.003	0.003	0.003
			(0.36)	(0.35)	(0.35)	(0.35)	(0.36)
Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes
State	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Brokerage Firm	Yes	Yes	Yes	Yes	Yes	Yes	Yes
# of Observations	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015
adjR2	0.009	0.009	0.016	0.016	0.016	0.016	0.016

Table 8: Stock Performance and Broker Misconduct

This table reports the results from linear probability regressions. The dependent variable equals one if the advisor has a misconduct case resolved against them in year *t* and zero otherwise. The unit of observation is advisor-year. *RET0wd_250m* is based on year *t* stock returns. It is the value-weighted average of year *t* stock returns for a portfolio of firms within 250 miles of the advisor's office. *RET0wd_100m (Ret0wd_500m)* are the same but for firms within 100 miles (500 miles) of the advisor's office. *RET0_250m* equal-weights the firms. *RET1ywd_250m* is based on year *t-1* stock returns. The control variables are defined in Table 1. The regressions include year, state, and brokerage fixed effects. The standard errors are clustered on year and county.

	1	2	3	4	5	6	7
RET0wd_250m	-0.477***	-0.452***	-0.420***				
	(-3.93)	(-3.80)	(-3.83)				
RET1ywd_250m				-0.290***			
				(-3.24)			
RET0wd_100m					-0.173***		
					(-2.61)		
RET0wd_500m						-0.617***	
						(-4.71)	
RET0_250m							-0.033
							(-0.42)
County_income		0.751***	0.622***	0.622***	0.623***	0.625***	0.626***
		(4.76)	(4.79)	(4.82)	(4.84)	(4.83)	(4.90)
County_Education		-1.647***	-1.443***	-1.445***	-1.447***	-1.450***	-1.453***
		(-5.27)	(-5.74)	(-5.78)	(-5.80)	(-5.80)	(-5.86)
County_GDP		0.000**	0.000**	0.000**	0.000**	0.000**	0.000**
		(2.38)	(2.41)	(2.38)	(2.40)	(2.39)	(2.43)
% brokers_misconduct			-0.332	-0.331	-0.322	-0.326	-0.322
			(-0.69)	(-0.69)	(-0.67)	(-0.67)	(-0.67)
Misconduct(last 3y)			5.065***	5.065***	5.065***	5.065***	5.065***
			(34.59)	(34.59)	(34.60)	(34.59)	(34.60)
Broker Size			-0.113***	-0.113***	-0.113***	-0.113***	-0.113***
			(-13.61)	(-13.75)	(-13.68)	(-13.64)	(-13.76)
Series63			-0.021	-0.021	-0.021	-0.021	-0.021
			(-1.47)	(-1.48)	(-1.48)	(-1.47)	(-1.48)
Series65			0.544***	0.544***	0.544***	0.544***	0.544***
			(11.76)	(11.75)	(11.76)	(11.76)	(11.74)
Series66			-0.033	-0.033	-0.033	-0.033	-0.033
			(-1.04)	(-1.03)	(-1.03)	(-1.04)	(-1.03)
Female			-0.389***	-0.389***	-0.389***	-0.389***	-0.389***
			(-11.72)	(-11.72)	(-11.72)	(-11.72)	(-11.72)
White			0.003	0.003	0.003	0.003	0.003
			(0.36)	(0.36)	(0.36)	(0.36)	(0.35)
Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes
State	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Brokerage Firm	Yes	Yes	Yes	Yes	Yes	Yes	Yes
# of Observations	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015
adjR2	0.009	0.009	0.016	0.016	0.016	0.016	0.016

Table 9: Local Firms versus Nonlocal Firms and Broker Misconduct

This table reports the results from linear probability regressions. The dependent variable equals one if the advisor has a misconduct case resolved against them in year *t* and zero otherwise. The unit of observation is advisor-year. The main independent variables are the difference between the value-weighted average of a portfolio of firms within 250 miles radius from the advisors' workplace and a value-weighted portfolio comprised of the firms outside of the radius. EPSgr is the analyst long term earnings growth forecast over 5 years. RET5y is the past 5 years stock returns. AFE)Med is the analyst earnings forecast error. RET0 is the year *t* stock return. EACAR33 is the cumulative abnormal returns over the window of 3 days prior to 3 days after the earnings announcement date. The control variables are defined in Table 1. The regressions include year, state, and brokerage fixed effects. The standard errors are clustered on year and county.

	1	2	3	4	5
Variable Names	EPSgr	RET5y	AFE_Med	RET0	EACAR33
Diff (Local-Nonlocal)	0.011***	0.290***	15.819***	-0.338***	-1.026***
	(3.35)	(5.34)	(3.82)	(-3.53)	(-3.24)
County_income	0.628***	0.630***	0.616***	0.623***	0.624***
	(4.88)	(5.03)	(4.84)	(4.80)	(4.87)
County_Education	-1.459***	-1.457***	-1.437***	-1.445***	-1.450***
	(-5.85)	(-5.91)	(-5.80)	(-5.76)	(-5.84)
County_GDP	0.000**	0.000**	0.000**	0.000**	0.000**
	(2.35)	(2.41)	(2.47)	(2.42)	(2.37)
%brokers_misconduct	-0.327	-0.424	-0.305	-0.333	-0.340
	(-0.68)	(-0.88)	(-0.64)	(-0.69)	(-0.71)
Misconduct(last 3y)	5.065***	5.063***	5.065***	5.065***	5.065***
	(34.60)	(34.60)	(34.59)	(34.60)	(34.60)
Broker Size	-0.113***	-0.113***	-0.113***	-0.113***	-0.113***
	(-13.69)	(-13.61)	(-13.82)	(-13.62)	(-13.81)
Series63	-0.020	-0.020	-0.021	-0.021	-0.021
	(-1.47)	(-1.41)	(-1.49)	(-1.47)	(-1.48)
Series65	0.544***	0.544***	0.544***	0.544***	0.544***
	(11.76)	(11.73)	(11.74)	(11.76)	(11.74)
Series66	-0.032	-0.032	-0.032	-0.033	-0.033
	(-1.03)	(-1.02)	(-1.02)	(-1.04)	(-1.03)
Female	-0.389***	-0.389***	-0.389***	-0.389***	-0.389***
	(-11.72)	(-11.73)	(-11.72)	(-11.72)	(-11.71)
White	0.003	0.003	0.003	0.003	0.003
	(0.36)	(0.37)	(0.35)	(0.36)	(0.36)
Year	Yes	Yes	Yes	Yes	Yes
State	Yes	Yes	Yes	Yes	Yes
Brokerage Firm	Yes	Yes	Yes	Yes	Yes
# of Observations	12,299,015	12,299,015	12,299,015	12,299,015	12,299,015
adjR2	0.016	0.016	0.016	0.016	0.016