Is all of my money really gone?
"No, of course not. It's just with somebody else!"
-Fund Manager*

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Abstract

Fund managers and misconduct. Nowadays, these terms are nearly synonymous. However, is there anything else we can pull as being compatible between the two? Through my research, I seek to identify personal characteristics of fund managers in which may correlate with financial wrongdoing. Financial misconduct has compelling impacts on an extensive range of levels. Possible effects may include but are not limited to, financial loss, reputation damage, investigation expenses, taxpayer dollars, regulator time, employee loss, and falls in consumer confidence, merely to name a few. I feel it unnecessary to remind everyone of the financial crisis in 2008 additionally, which left near all with a loss of faith in the entire system. My work tests fund manager identifiers with their relationship to delinquency. Perhaps if we can shed light on particular traits linking to this financial misconduct, the problem can be better addressed and combatted.

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1. Introduction

My aim is to research the possible relations between individual qualities and financial misconduct. This is a fairly novel area of research seeing as it is not overly saturated in the literature. There are several fundamental papers I reviewed in educating myself for this topic. The first is "Financial Fraud, Director Reputation, and Shareholder Wealth" by Fich and Shivasani (2007). These authors dig into the effectiveness of corporate governance and certain incentive mechanisms, stating "understanding the underlying causes contributing to fraud is important to assessing whether the slate of governance forms is likely to result in meaningful improvements in the quality of corporate governance," which is what I too am after. The difference however, is that in their study they focus a good deal on outside directors rather than internally on fund managers themselves. What I do take from this paper though, is using class action lawsuits in identifying the episodes of financial misconduct versus either an announcement of an earnings restatement or Securities and Exchange Commission (SEC) Accounting and Auditing Enforcement Release (AAEAR). This is advantageous for a few reasons. For starters, not all firms restate their earnings prior to the lawsuit filing. Also of note, ascertaining financial reporting violations via these press releases or AAEAR may miss several occurrences of reporting breaches along with numerous companies getting delisted before the regulators even formally file their charges, as Karpoff, Lee, and Martin (2004) bring to attention. The critical entity about class-action lawsuits is the fact that they are filed quickly following disclosures for reporting infringements.

Typically, drawbacks with this approach include solely having the disclosure and no outcomes. Or perhaps, if the outcome is accounted for, only the settlement amount is included. However, my data include whether or not the case was dismissed along with sanctions included for the investigation in order to provide a better story of what happened with the case. Additionally, factors that affect the probability of financial fraud is an emerging literature. From what I've seen, most research involves looking into misconduct at a high-level with elements such as board composition and executive compensation for firms

engaged in fraud (Dechow, Sloan and Sweeney (1996), Beasley (1996), Agrawal and Chadha (2005), Burns and Kedia (2005)). My goal is drilling down into the most basic form in which financial misconduct takes place, and that is between a fund manager and his or her client.

"The Geography of Financial Misconduct" by Parsons, Sulaeman, and Titman (2014) is similar to my track in focusing on the broader picture of financial misconduct. Certain characteristics are also investigated but again, more at the elevated approach seeing as they include major U.S. cities, corporate corruption, peer effects, and political fraud. These authors endeavor to measure the significance of social norms for white-collar crimes by manipulating location as the central distinctive source. An interesting find is that financial misconduct tends to cluster in certain cities, disproportionately. From there, I'm engrossed in seeing if even within a reduced scope, certain individual characteristics also tend to group disproportionately, if you will. In fact, the paper explicitly states, "while norms appear to be important for understanding misbehavior, pinpointing their determinants is more challenging."

Intentionally speaking, a demographic used was education. Previous authors have published the robust associations between education and crime (Lochner and Moretti (2004)) as well as corruption (Cheung and Chan 2008). What I am delving into includes seeking a correlation between that of factors such as an Ivy League education and/or a graduate degree with what role they play in affecting the probability for financial misconduct. "The Market for Financial Advisor Misconduct" by Egan, Matvos, and Seru (2017) also discusses characteristics. A dominant component for their study includes frequency, dialing in on serial offenders. They find that past offenders "are five times as likely to engage in new misconduct as the average financial advisor."

The deduction of this dejected enumeration involving financial misbehavior is found in Naomi Wolf's subtitle of her article "This Global Financial Fraud and Its Gatekeepers," as: "The media's 'bad apple' thesis no longer works. We're seeing systemic corruption…" Hence why isolating specified predictors is of the essence. Explicitly, I key in on four

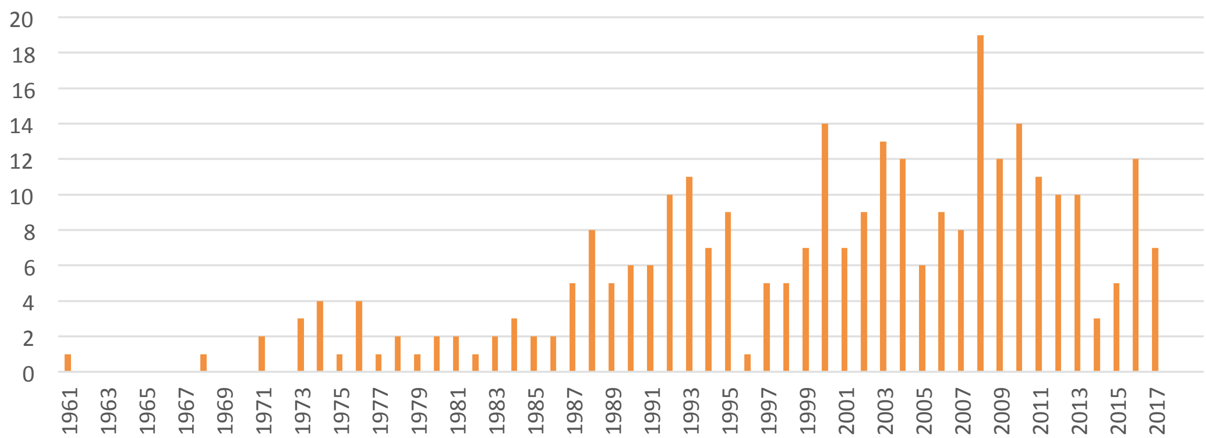
distinguishing qualities. My causal constructs include gender, undergraduate nationality, Ivy League influence, and graduate degree. I do believe that particular attributes of an individual play a role in whether or not that person will commit financial transgression. My effect construct is then broadly speaking, financial misconduct. Specifically stating, I theorize that an individual who is male, domestically educated in the United States, has Ivy League influence, and obtains a graduate degree is more likely to commit financial misconduct than that of the binary alternative being female, educated abroad, no Ivy League influence, and no graduate degree. My prior comes from previous theories consisting of ideas such as overconfidence, narcissism, and "can do no wrong" all intertwining with one another. I've picked up on this research from the likes of both Arizona State University faculty and students such as Denis Sosyura, Fangfang Du, and Goeun Choi. So, why is this question exigent? Why do ASU researchers care?

It's no secret that financial companies are known for their rife deception, fraud, and self-interested actions. Minimally a few of these include Barclays Bank and others colluding to manipulate interest rates, Hong Kong and Shanghai Banking Corporation fined one billion dollars for not preventing money laundering between 2004 and 2010, 215 million dollars of customer money "missing" at Peregrine Capital, whose founder faced criminal charges after a suicide attempt, Wells Fargo agreeing to pay 175 million dollars in fines for automatically charging African American and Hispanic mortgagees costlier rates on their subprime mortgages than white people with identical credit ratings. Fined for the same practice are Bank of America and SunTrust (Keller 2016). These events stem from activities that are highly lucrative not to prevent. This is where the prevalence and significance of financial advisors arises. It has been shown that these managers are commonly thought of and regularly ranked as the least trustworthy professionals (Edelman Trust Barometer 2015, Wall Street Journal "Brokers are Trusted Less than Uber Drivers, Survey Finds").

Egan, Matvos, and Seru (2017) took it upon themselves to perform the first large-scale study authenticating the economy-wide extent of misconduct among both financial advisors

and financial firms. Their results concluded that a response of natural policy to lowering misconduct would be an increase in market transparency and more definitively, in the policies targeting unsophisticated consumers. I seek to build upon this with also incorporating what may help at an individual-level as well. The following figure illustrates the count of disclosures increasing from 1961 to 2017, exhibiting the increase in quantity and why this is a real time issue, proving an emergent topic.

Figure 1: Disclosure Frequency



For a story to be a story, there must first be a problem making life not as it ought to be. Enter financial misconduct. A story must also contain some idea and opportunity for things being put right. So a story, as us researchers aspire to write, must have an account of how life should be, an explanation of how it got thrown off balance, and some proposed solution as to what will put life right again. Thus far I have elucidated the problem and effects of the misconduct making life not as it ought to be and now seek how to put things right. Perhaps I don't ideally know how life should precisely be in this fund manager-related sense, however I do realize what it should *not* be and that is as it is now in its current state. Building on this, the next step includes an explanation as to how this got thrown off balance, which I will

conduct by dialing in on my explanatory variables previously identified. From there I will look into a proposed solution but first, data.

2. Data

The most exciting and novel part of this paper is my data. A good deal of sweat equity has gone into my research considering the vast majority of it was hand-collected. This is an interesting topic because not much work has been done regarding fund managers due to the lack of readily available, already processed data. My core source is from the Financial Industry Regulatory Authority (FINRA) with broker checks, as these cases contain public information concerning allegations against fund managers. BrokerCheck is the most comprehensive source of information regarding both the regulatory history and professional background of brokers. My approach was reading through each of the disclosures, differentiating the information accordingly, categorizing the appropriate subjects, coding the proper category, and finally, modeling the data simply. The data include two main files that I will break down for further understanding my work.

My first key file details all the fund managers registered with FINRA. From there, they are organized by their disclosure frequency, accordingly. The observations serve as the fund managers themselves along with their corresponding disclosure counts, disclosure types, misconduct start and end dates, disclosure dates, allegations filed, allegation types, damages requested, amounts settled, initiators identified, initiation types, disclosure resolutions, sanction details, sanction outcomes, case record numbers, outcome dollars, publicity links, publicity outlets, publicity dates, companies mentioned, and funds mentioned. Out of this, what was explicitly given from FINRA includes everything except for the misconduct start and end dates, allegation types, damages requested, amounts settled, initiation types, sanction outcomes, outcome dollars, publicity links, publicity outlets, publicity dates, companies mentioned, and funds mentioned. Meaning, the differentiator coming from my work not only

emanates from the limited amount of people pulling from FINRA, but also from there, taking it steps further in a supplementary, meticulous analysis process.

Allegation types, for example. FINRA will list the specific allegations charged in opposition to the manager. However, how does one compare all of these unstandardized comments? Let alone, run analysis to try and learn or discern anything from them. Most research I reviewed allotted for financial misconduct alone, in a binary sense. Either it was committed or it was not, period. I on the other hand, classified this financial wrongdoing into 17 categories. The first five cases are shown below in **Table 1: Allegation Codes**.

Code:	Category:	Count:	Description:
1	Theft	7	Petit Larceny, College Prank (Stole: chicken wire, compact disks, signs), Petty Theft, Receiving stolen property, Retail Theft
2	Misrepresentation	27	False statements of material facts, Omission, Materially false advertisements, Unapproved changes in policy, Exaggerated performance data, Misstatements, Outside business activity involvement, Aided and caused the fund to overstate its net asset value, Falsifying internal reports
3	Unauthorized Trading	20	Effected trades in the account of a customer which were unauthorized, Excessive trading, Operated without a registered FINOP, Unauthorized transactions, Trade inconsistent with recommendation, Not registered, Unsuitable Trading, Failed to follow instructions, Fictitious trading, Fail to obtain effective consent, Improper trading, Dumped offerings into the accounts of unwitting and unsuitable retail clients
4	Unsuitable Investments	46	Unhappy with alleged high cash position in account. Client protested last fee charged for account, Effected transactions in the account of a customer which were unsuitable in view of the financial resources investment experience and investment objectives of the customer, Failure to follow instructions, Unsuitable trades, Unsuitable investments, Portfolio too risky
5	Negligence	29	No written investment advisory contracts, independent representative for Funds did not review transfers between funds, failure to disclose material conflicts to clients including the absence of such disclosure in the Form 2A, Negligent account management, Failure to supervise, Failed to maintain monthly bank reconciliations, allowed for customer exceeding the applicable position limit in stock options for one day, Mismanagement of accounts, Prepared inaccurate books and records and filed inaccurate focus reports, Neglect, Negligent conduct, Possession of Controlled Substance

As one can read from some of the descriptions, it was also important to classify which allegations directly applied to fund management related activity as well. Hence, this was also noted and taken into account. One allegation could similarly correspond with more than one code as well in order to achieve a holistic picture. Likewise, the initiator was analyzed further through coding from the individual to National Association of Securities Dealers (NASD),

SEC, and FINRA levels. Finally, the sanction outcomes were treated in a consistent manner as well. I have shown this below in a sample for clarity with **Table 2: Outcome Codes.**

Code:	Category:	Description:
1	Settlement	Explicitly stated or by definition: an official agreement intended to resolve a dispute or conflict; Undertaking
2	Denied	Dismissed; Closed-No Action; Dissolved and Vacated; All allegations dropped; Full presidential pardon granted; Resolved; Received no further communication from customer; Voluntary Resignation; Withdrawn
3	Censure	Explicitly stated or by definition: express severe disapproval of (someone or something), typically in a formal statement; Reprimanded
4	Bar	Explicitly stated or by definition: to officially prevent someone from doing something or going somewhere, or to prevent something from happening
5	Community Service	Explicitly stated

My subsequent central file features aspects of the fund managers' education backgrounds. I reviewed all of my managers whose FINRA record exists. From there, I found when applicable where the manager went to school for his or her undergraduate studies, the graduation year, type of degree earned, and the respective field of study. Additionally, if a manager pursued further scholarship, I also logged any graduate degrees earned transpiring similarly as with the information previously assembled for undergraduate information. This correspondingly comprises graduation year, degree, and field of study. As one may or may not imagine, this information was not all readily available nor nicely recorded in FINRA. This component required much research, profile pursuits, and perhaps most fundamentally as the classic favorite, Google searches, and many of them. Morningstar, Bloomberg, and LinkedIn served as invaluable resources in acquiring all of this data.

3. Methodology

My methodology is incredibly basic. The approach I took for this paper originates from a lesson I learned in a preceding class: KISS. The acronym stands for "Keep it simple, stupid" as was the intention standard distinguished in 1960 by the U.S. Navy. Basically, the idea in principle is saying that most methods work best if they are kept simple versus complex. Hence, simplicity is

the fundamental goal in my design and I will be adopting KISS to furthermore connote "Keep it simple, Stewart." Please notice that I did say simple, and that is by no means tantamount to easy.

With that being said, this paper involves a simple model. I thought to myself as earlier voiced in the introduction, financial misconduct is clearly an issue and undoubtedly has a sizable span. What is the most basic form one can condense this down into for research? After much thought, I found my answer to be involving a fund manager and that relationship to his or her clients. What causes a manager to engage, or abstain from engaging, in financial transgression on the smallest scale of the spectrum with his or her patrons? My next idea concerned if there were possible, distinct characteristics that stood out among managers where certain people filling these roles shared, and also associated with financial misconduct.

Accuracy is obviously critical so I examined my data to see which factors would best divulge the most truthful story about my observations. In other words, which factors did I have the greatest detailed information recorded in its entirety? With that criterion, my causal constructs came to fruition as gender, undergraduate nationality, Ivy League influence, and graduate degree. The effect construct was then financial misconduct. Plain and simple: four independent variables with one dependent. My research is truly pursuing the very core of financial wrongdoing and what types of associations may correlate.

There were 2156 comprehensive observations, the number of fund managers in my sample. I implemented a binary coding process on each of my individual characteristics. Classifying all by hand, row by row to determine if the gender was male or female, undergraduate degree was in the United States or abroad, any degree was from an Ivy League school, graduate degree was obtained or not, and if financial misconduct had been committed. Once this process was complete, I used Stata to run my findings and derive the results.

4. Results

In Stata, I ran several straightforward statistics to gauge correlation. Probit model was the type of regression I processed seeing as I limited my variables for cleanness to binary outcomes. My theory stated that I believed all of my variables would prove to be significant as well as showing

particular, explicit characteristics associating with that of financial misconduct. These individual factors playing a role with increasing the probability of delinquency include male, domestic, Ivy League influence, and graduate degree. Oddly enough, my results were not an exact match to my prior notions ex-ante.

My estimations found only the predictors of gender and graduate degree to be significant. Also noteworthy, my regression found a negative correlation between those managers domestic in their undergraduate studies and also having an Ivy League influence. The explanatory variable of Ivy League alone failed to be meaningful however, when paired with nationality, showed implication. This is better illustrated quantitatively via

Table 3: Individual Qualities & Financial Misconduct.

	(1)	(2)
VARIABLES	*FMC*	*FMC*
Gender	0.607**	0.610**
	(0.237)	(0.237)
Nationality	0.141	0.572
	(0.271)	(0.406)
Ivy League	-0.0482	1.224**
	(0.113)	(0.595)
Nationality × Ivy League		-1.317**
		(0.605)
Graduate Degree	-0.207**	-0.207**
	(0.0900)	(0.0902)
Constant	-2.100***	-2.525***
	(0.358)	(0.469)
Log Likelihood	-499.92318	-497.54269
Observations	2,156	2,156

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

For further clarification, men are more prone to this financial misconduct (FMC) as well as those without a graduate degree. Or in other words, being male increases the likelihood of FMC and having a graduate degree decreases the likelihood, separately. My interpretation also reveals that in Model 2 (2), Ivy League graduates are more likely to have FMC. When paired

with nationality as a synergy effect, Ivy League becomes a statistically significant factor. The interaction then tells us that being international and having Ivy League influence, the likelihood of committing FMC is higher when compared to a domestic manager with an Ivy League effect also. This second model considers the interaction between Ivy League and nationality. Thus, enabling a greater understanding for estimation on the effect of contingency between them. Model 1 (1) displays each of the variables singularly, just to be clear.

5. Conclusion

Based upon my results, I have drawn several new theories. In regards to the first one considering gender, there is much literature already depicting men to having higher confidence, being bigger risk takers, ensuing as narcissists, and therefore making my findings logical with males engaging more into financial misconduct. Graduate degrees then, perhaps if a fund manager earns one, also is held to a higher standard and does not want to tarnish his or her reputation as an ethical, graduate degree holder. Hence, these fund managers are either refraining from financial transgression or maybe even being "more sophisticated" in knowing how to avoid the regulation. I find the most intriguing piece though, to be the Ivy League factor and how it transforms from insignificant to significant merely by adding the contingency of nationality. My alternative idea here for rationalization would be along the lines of reputation as well. When comparing Ivy League managers from domestic to international, the domestic ones would typically have a vaster network here in the United States and consequently, have a grander character to maintain and protect in his or her respective society. International managers on the other hand, have an "exit," if you will. Say worse comes to worst for the international manager and reputation is ruined. Chances are, that individual can still go home to conduct business, exclusively given his or her prominent Ivy League influence most likely still being favorably esteemed there.

My purpose of this research was to find possible associations between individual characteristics and financial misconduct. This is important and people should care because it is an emerging and prevalent subject affecting an indefinite amount of sectors both in the worlds of

industry and academia. Ideally, this matter could be more effectively dealt with if more was known concerning the root causes. Acquiring my data took much sweat equity bearing in mind that much of it was qualitative. However, this is beneficial due to the fact that I know nobody else has what I do and consequently, escalating the value of its novelty. As addressed in my data section, my observations have pronounced breadth. I realize my methodology opted KISS however, that was purposeful. At this point, I have run the regressions I am currently capable of conducting and nevertheless, am excited for the potential embedded with this data. Even with the simple approach, I was able to ascertain that gender, graduate degree, and a joint synergy between nationality and Ivy League influence all materialize statistically significant. These are by no means anomalies and align with most of the preexisting literature. I am happy to contribute these results and hope to help enrich further research.

In moving forward, I very much welcome any and all suggestions regarding my research. I've been talking to several faculty members and fellow students across the departments of Arizona State University in detailing how best to proceed. Ideas have ranged from matching my fund managers to the respective portfolios for further financial analysis. Merely, the data bridge has not yet been created between my managers and the funds. Therefore, as of present, this will all need to be done individually and by hand, much like the near entirety of my other observations thus far. Also something I find of interest would be since I have already identified and established exclusive types of misconduct, being able to drill further into this facet. I have yet to see this particular approach taken before, making me especially keen to do so. This is versus taking financial misconduct as a whole and not differentiating between the types, say between petty theft and fraud. Another element I would love to evaluate along with my current independent variables would be the Chartered Financial Analysis program, seeing if there is any link between this ethics training and financial misconduct. Ultimately, feedback would be amazing as to which direction I should take my work for the purpose of contributing as best I can at this point and also serving most meaningful to this field. Thank you for reading my first

research paper and I look forward to learning more from the best! I sincerely appreciate your time ☺ Take care and God bless!

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