

ONLINE APPENDIX TO COMMISSIONER ROBERT J.  
JACKSON, JR. STATEMENT ON FINAL RULES  
GOVERNING INVESTMENT ADVICE

June 5, 2019

## Data and Methodology

We scrape all 507,082 Investment Advisers' Form ADV Part II Brochure filings from 2007–2018 for the first mention of 'fiduciary' and extract the subsequent 500 characters to see how firms describe their fiduciary duties to their clients.

We focus on two specific regular expression patterns:

- `interest[s]?.{1,100}first` as in “fiduciary duties to clients [...] endeavors at all times to put the interests of its clients first”
- `subrogate|subordinate|suborn` as in “fiduciary duty to ensure that the welfare of our clients is not subordinated to any interests of ours or any of our personnel”

We compute the total AUM managed under each standard in each year by summing over all firms where we find at least one of the relevant text patterns. While there are many other potential fiduciary standards described specifically in the brochures, we focus on these two as they are most relevant to the actual language considered in the Rulemaking.

We obtain additional data ending in 2015, extracted from ADVs and the SEC's administrative proceedings and litigation release pages as collected by Dimmock et al. (2018) to use as control variables.<sup>1</sup>

Dimmock and Gerken (2012) shows that past regulatory, civil, and criminal actions, as well as conflicts of interests predict subsequent fraud. We focus on predicting conflicted behavior, based on the “plain English” disclosures to investors through investor advisor brochures.

Specifically, we run cross-sectional regressions with year fixed-effects where the dependent variable is a measure of conflicts of interest. We control for a variety of firm characteristics including size (AUM, average account size), past misconduct (fraud, regulatory, civil or criminal violations), as well as

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<sup>1</sup>Data from <https://doi.org/10.13023/nsjd-rk62>.

other potential conflicts (soft dollars, referral fees, employs broker representatives).

We consider two measures of conflicted advice, “Interest in transaction” from Dimmock and Gerken (2012) which is based on Items 8.A.(1), 8.A.(3), 8.B.(2), 8.B.(3). We also adopt a stricter version of conflicted advice, which is based only on Items 8.A.(3) and 8.B.(3) which refer only to the recommendation of products where the firm has proprietary or sales interest. We include the description of Form ADV Part I Item 8 in Section Form ADV Part I Item 8.

## Results

Table 1 presents results from cross-sectional logistic regressions. We include year fixed-effects because we care about differences between firms and what language they use. Firms that describe themselves as “client interest first” are less likely to offer conflicted advice, and firms that use “subrogate” language are far more likely to offer conflicted advice. Moreover, firms that offer conflicted advice are more likely to be those that have committed past fraud, faced past civil or criminal charges, or faced past regulatory action.

Table 1: Predicting conflicted advice based on “plain English” Investment Adviser brochure language.

	Interest in transaction		Conflicted advice only	
	(1)	(2)	(3)	(4)
“interest first”	-0.193*** (0.069)		-0.198*** (0.056)	
“sub[ordinate]”		0.729*** (0.196)		0.734*** (0.199)
Past fraud	1.168*** (0.104)	1.166*** (0.107)	0.743*** (0.068)	0.738*** (0.070)
Past regulatory	0.807*** (0.030)	0.807*** (0.030)	0.640*** (0.022)	0.640*** (0.022)
Past civil/criminal	0.700*** (0.062)	0.703*** (0.061)	0.552*** (0.071)	0.555*** (0.070)
log AUM	0.169*** (0.016)	0.168*** (0.016)	0.192*** (0.019)	0.191*** (0.019)
log Average Account Size	0.261*** (0.007)	0.262*** (0.007)	0.196*** (0.012)	0.196*** (0.012)
Soft dollars	0.342*** (0.022)	0.338*** (0.022)	0.409*** (0.022)	0.406*** (0.022)
Age	0.001 (0.001)	0.001 (0.001)	0.002*** (0.001)	0.002*** (0.001)
Referral fees	1.004*** (0.093)	1.004*** (0.094)	0.950*** (0.066)	0.950*** (0.067)
Broker in firm	0.440*** (0.071)	0.439*** (0.071)	0.394*** (0.064)	0.393*** (0.064)
Obs.	45,228	45,228	45,228	45,228

Specifications include year fixed-effects. \*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$

## Form ADV Part I Item 8

### Item 8 Participation or Interest in Client Transactions

#### Proprietary Interest in Client Transactions

A. Do you or any related person:

(1) buy securities for yourself from advisory clients, or sell securities you own to advisory clients (principal transactions)?

(2) buy or sell for yourself securities (other than shares of mutual funds) that you also recommend to advisory clients?

(3) recommend securities (or other investment products) to advisory clients in which you or any related person has some other proprietary (ownership) interest (other than those mentioned in Items 8.A.(1) or (2))?

#### Sales Interest in Client Transactions

B. Do you or any related person:

(1) as a broker-dealer or registered representative of a broker-dealer, execute securities trades for brokerage customers in which advisory client securities are sold to or bought from the brokerage customer (agency cross transactions)?

(2) recommend to advisory clients, or act as a purchaser representative for advisory clients with respect to, the purchase of securities for which you or any related person serves as underwriter or general or managing partner?

(3) recommend purchase or sale of securities to advisory clients for which you or any related person has any other sales interest (other than the receipt of sales commissions as a broker or registered representative of a broker-dealer)?

## References

Dimmock, Stephen G, Joseph Farizo, and William Christopher Gerken, 2018, Misconduct and fraud by investment managers, in Carol Alexander, and Doug Cumming, eds., *Corruption and Fraud in Financial Markets: Malpractice, Misconduct and Manipulation* (Wiley).

Dimmock, Stephen G, and William C Gerken, 2012, Predicting fraud by investment managers, *Journal of Financial Economics* 105, 153–173.