Ex-SEC member targets rogue brokers turning to insurance sales

Study co-authored by Robert Jackson Jr. shows that 'wandering advisers' who leave one regulator and continue operating under another are more likely to commit misconduct.

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Former Securities and Exchange Commission member Robert Jackson Jr. hopes to focus the attention of lawmakers and his former regulatory colleagues on the dangers posed to investors by rogue brokers who remake themselves as insurance professionals.

Jackson, who is now a professor at the New York University School of Law, co-authored a recent study that examines financial advisers who commit misconduct under one regulator, then continue to operate under a different regulatory regime.

The paper, Wandering Financial Advisors, concludes that brokers with a history of serious misconduct who leave the brokerage industry are disproportionately likely to end up selling insurance and also are significantly more likely to engage in future misconduct.

The Financial Industry Regulatory Authority Inc., the broker self-regulator, has created a system through its BrokerCheck database that discloses broker misconduct to investors. But brokers can escape that kind of oversight when they drop their Finra registration and operate under a different regulator, such as state insurance commissioners, Jackson said.

“It’s a very significant threat to ordinary American families who are trying to save for their retirement,” Jackson said. Finra disclosure “gives investors a fighting chance to go online and to look to see in whom they’re trusting their money. But wandering allows that broker to escape that accountability by hiding in a state-level regime that allows them to continue hurting investors with no disclosure about what is happening.”

Insurance is regulated on a state-by-state basis.

“State commissioners are steadfast in their commitment to protect consumers from bad actors and those who believe they can escape regulation by moving to the insurance industry will be sorely disappointed,” the National Association of Insurance Commissioners said in a statement. “There is ongoing sharing of licensure information between FINRA and the NAIC. In 2019, the NAIC’s State Producer Licensing Database was updated to identify matched individuals in both the FINRA and NAIC databases.”

The problem that Jackson and his co-authors — Edwin Hu, a fellow at the New York University Institute for Corporate Governance and Finance, and Colleen Honigsberg, a law professor at Stanford University — highlighted has been created by the patchwork of regulatory oversight of brokers, investment advisers and insurance professionals, he said.

“This is a problem of the law’s own making,” Jackson said. “Because it’s a problem the law has created, it’s a problem the law can fix.”

Jackson, who served as a Democratic SEC member from 2018 to 2020, is now an academician trying to persuade his former colleagues to take action on an investor protection threat.

“What I’ve heard [SEC] Chair [Gary] Gensler say repeatedly is that he’s keen to know the facts about what’s happening on the ground with American families who are trying to save for their retirement,” Jackson said. “My hope is these facts are helpful in helping him think through what the right next steps are.”

FIRST STUDY OF WANDERING ADVISERS

The study, which says it is the first to examine wandering advisers, is based on a review of 1.2 million financial advisers who were overseen by Finra or the SEC or were insurance producers or members of the National Futures Association between 2010 and 2020.

The researchers found that 395,887 individuals exited BrokerCheck — dropping their Finra registration — during the decade, with 133,827 of them remaining registered in another regime. Those who continued to provide financial advice in a capacity other than as a Finra-registered broker were identified as “wandering advisers.”

The study shows that 4.63% of Finra-registered brokers have serious misconduct on their record, compared to 7.81% of wandering advisers. Among brokers who leave Finra and continue working as insurance salespeople, 13.44% have a history of serious misconduct.

“In short, the baseline rates of misconduct and serious misconduct among all FINRA brokers more than double for those who wander away from the FINRA regime but continue providing financial advice as insurance brokers and NFA members,” the study states.

REMOVING BROKER HAT

Many Finra-registered brokers already sell insurance products, such as variable annuities.

“It’s very easy for them to just drop out of the broker side and continue doing what they were already doing,” Hu said. “Our understanding is that there’s maybe a lighter-touch regulatory environment on the insurance side. You’ll get, for example, a state securities regulator who has an issue with an adviser and they’ll make a referral to the insurance side because that person also sells variable annuities. They don’t know what happens after that. There’s no follow-up. It’s kind of like a black hole.”

One of the challenges of insurance regulation is that many salespeople are independent contractors. They don't have a firm monitoring their activities.

"Selling variable annuities is easier to do without as much oversight," Hu said.

The study recommends addressing the wandering adviser threat by constructing a unified database of financial advisers and insurance salespersons, implementing systemic tracking of registrations, stepping up licensing review, establishing a customer dispute resolution system for the insurance industry and forcing insurance firms to pay judgments in cases won by customers.