External Labor Market Punishment in Finance

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The Paper in One Slide

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- Three groups of workers: (i) separated for misconduct; (ii) separated for no fault of their own; (iii) continuously employed
- Use the earning dynamics of the continuously employed as a benchmark for the earnings dynamics of both type of separated workers - compare finance and non-finance

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1. Employees separated for misconduct in the **finance sector** suffer a smaller drop in earnings than the one experienced by employees laid-off for no fault of their own
   $\rightarrow$ Misconduct separations act as a signal for employers who value these employees
2. Relation btw misconduct and earnings following separation reversed in **non-finance sectors**

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   → Misconduct separations act as a signal for employers who value these employees
2. Relation btw misconduct and earnings following separation reversed in **non-finance sectors**
   → What drives this difference?

Pay premium for misconduct in finance

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1. **Why using the continuously employed as a control group?**

- Comparing the two types of separated employees takes care of the "common shock" due to separation and allows for a clear identification of pre vs post separation windows
- Data allows to observe separations for "business" reasons - significant improvement with respect to endogenous turnover!

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  - (i) No fault $\rightarrow$ Mean $=$ 111 ; p25 $=$ 51; (ii) Misconduct $\rightarrow$ Mean $=$ 62; p25 $=$ 36

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- "Floor" for wages in finance may make the earnings drop in the misconduct group smaller
  - (i) No fault: Mean $\rightarrow$ p25 $= \downarrow 54\%$; (ii) Misconduct: Mean $\rightarrow$ p25 $= \downarrow 41\%$

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- Wage distribution of misconduct is more compressed also in non-finance sectors...but to a lesser extent: (i) No fault: Mean $\rightarrow$ p25 $= \downarrow 54\%$; (ii) Misconduct: Mean $\rightarrow$ p25 $= \downarrow 46\%$

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▸ Adding FE for earning bins is in principle a great idea but if little overlap in the two distribution, then the estimation is done with quite a bit of extrapolation

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- Assortative matching: advisers who committed misconduct disproportionately likely to match with firms characterised by more misconduct and less severe punishment
- **Bad advisers still punished**: (i) higher probability to exit the industry; (ii) longer gaps between employment spells; (iii) move to firms with lower compensation

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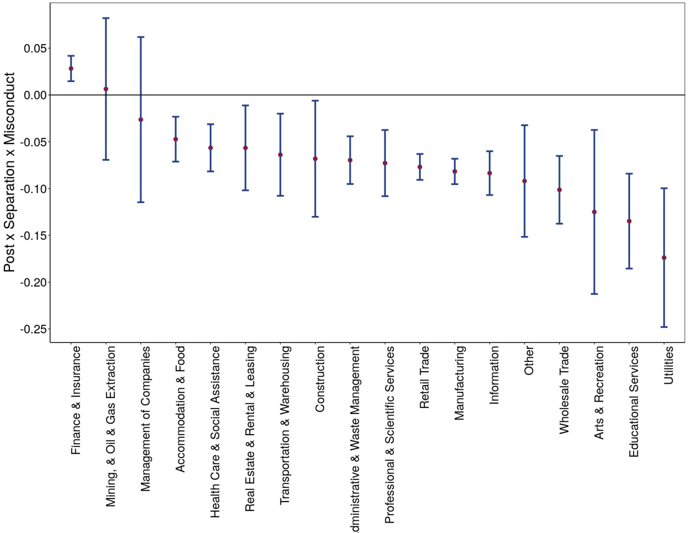
- Why does this paper finds the opposite with respect to (ii) and (iii) (no evidence about (i))
  - Different control group? Different coverage of the finance industry? Different firms?

Consequences of misconduct in finance vs non-finance

Relation between misconduct and relative drop in earnings is reversed in non-finance sectors



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1. **Differential selection of workers into misconduct across sectors**

- "Differences across employees separated for misconduct and no fault cannot explain the results unless they systematically vary across industries" $\rightarrow$ not so implausible!
- Check if proportion of re-offenders varies across industries: is misconduct in other industries less concentrated among professionals?
  - You can check if committing misconduct is more informative of worker's "type" in finance
  - Egan et al (2019) mention that annual incidence of medical malpractice is similar to that of financial advisers misconduct, but much less concentrated among physicians
  - More likely to be due to "random" mistakes rather than systematically unethical behavior

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- "One feature that makes finance unique may be that most services and products sold are based on future cash flows. This makes it more difficult for consumers to disentangle bad luck from a deliberate risky or unethical transaction in case of losses"

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- Similar features can be found also in other industries!
  - Difficult for consumers to ascertain the value of services provided by professionals such as doctors, attorneys, accountants...
  - Can select industries on this feature to check importance of this explanation: may be plausible in theory but not supported empirically

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- "Inherent culture in the finance sector may be systematically different than other sectors"

- Is the proportion of firms that punish misconduct with termination different between finance and non-finance?
  - The paper shows that conditional on being punished through job termination, earning punishment is less severe in finance - but what about the extensive margin?
  - Showing differences in punishment through job termination across industries seems informative to speak about industry culture!

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  - In finance, results in finance are driven by those who remain in same sector. *Heterogeneous effects depending on the industry of destination also in the other industries?*
  - In finance, results are driven by those who start from a low-misconduct firm and move into a high-misconduct firm. *Does this play a role also in the other industries?*

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  - In finance, results are driven by those who start from a low-misconduct firm and move into a high-misconduct firm. *Does this play a role also in the other industries?*
- Perhaps matching is less likely to occur in non-finance industries because of info frictions?
  - Disclosure of financial misconduct is public - making it easier to identify it and punish/reward
  - If misconduct is not public in other industries, extent of matching is lower - but this could go both ways!

Other small comments

- Description of the data and matching with the continuously employed (triple diff. only)
- Discussion of the differential attrition within the dataset: those separated for misconduct in the finance industry are 14% less likely to drop out the sample
- Discuss why separations due to misconduct are much more common outside finance (54% vs 40%)
- Violation of company policy is deferentially interpreted across sectors?
- Are firms with above median misconduct characterised by lower wages in general? It may be about steepness of wage profile
- Who are non finance employees in the finance industry? Can they really commit misconduct?