Political Contributions by Investment Advisers and Voluntary Disclosure

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September 10, 2025

Abstract: The integrity of capital markets depends on transparent investment advisory relationships, particularly in the public sector where political contributions by investment advisers create potential conflicts of interest through "pay-to-play" arrangements that compromise capital allocation efficiency and undermine investor confidence. The Securities and Exchange Commission's 2009 prohibition on pay-to-play practices provides a unique natural experiment to examine how eliminating political influence affects corporate disclosure behavior through the litigation risk channel. This regulatory change fundamentally altered the competitive landscape by removing political connections as competitive advantages and increasing reliance on performance-based differentiation, theoretically creating heightened litigation risk exposure that should incentive enhanced voluntary disclosure as a defensive mechanism. We empirically analyzed the relationship between political contribution restrictions and voluntary disclosure behavior using difference-in-differences methodology with firm-level controls and fixed effects. Our findings reveal counterintuitive results: the baseline specification shows a significant negative treatment effect, and the most comprehensive specification indicates a modest but statistically significant decrease in voluntary disclosure following regulatory intervention, contrary to theoretical predictions. Control variables demonstrate that firm size positively affects disclosure while poor performance reduces voluntary disclosure. These results suggest that eliminating political

influence may reduce rather than increase disclosure levels, potentially because advisers previously engaged in higher disclosure for relationship-building with politically connected clients, or because merit-based competition reduced extensive voluntary disclosure needs when performance metrics became primary evaluation criteria. This study contributes novel evidence on indirect effects of political contribution restrictions operating through litigation risk channels, revealing that regulatory interventions eliminating political influence may not automatically enhance transparency if underlying economic incentives favor reduced disclosure in new competitive environments.

INTRODUCTION

The integrity of capital markets fundamentally depends on the transparency and objectivity of investment advisory relationships, particularly in the public sector where fiduciary responsibilities extend beyond traditional profit maximization to encompass broader stakeholder interests. Political contributions by investment advisers have historically created potential conflicts of interest through "pay-to-play" arrangements, where advisory contracts may be influenced by political donations rather than merit-based selection criteria (Christoffersen and Sarkissian, 2009; Hochberg and Rauh, 2013). These arrangements not only compromise the efficiency of capital allocation but also create information asymmetries that can distort market functioning and undermine investor confidence in the advisory selection process.

The Securities and Exchange Commission's 2009 prohibition on pay-to-play practices by investment advisers represents a significant regulatory intervention designed to eliminate political influence in adviser selection and restore merit-based competition in the industry. This regulatory change provides a unique natural experiment to examine how the elimination of political rent-seeking affects corporate disclosure behavior through the litigation risk channel (Brown et al., 2021; Kedia and Rajgopal, 2011). While prior research has extensively documented the relationship between regulatory changes and disclosure practices, the specific mechanism through which political contribution restrictions affect voluntary disclosure via litigation risk remains underexplored, creating an important gap in our understanding of how regulatory reforms influence corporate transparency and information production.

The elimination of pay-to-play practices fundamentally alters the competitive landscape for investment advisers by removing political connections as a source of competitive advantage and increasing reliance on performance-based differentiation. This shift creates heightened litigation risk exposure as advisers can no longer rely on political relationships to shield them from performance-related scrutiny, thereby increasing their incentives to provide more comprehensive voluntary disclosure to mitigate potential legal challenges (Johnson et al., 2001; Skinner, 1994). The theoretical foundation for this relationship rests on the litigation risk hypothesis, which posits that firms increase voluntary disclosure when facing higher probability of litigation, as additional disclosure can serve as a defensive mechanism against future legal action by providing evidence of good faith efforts to inform stakeholders about material risks and performance metrics.

Under the pay-to-play regime, investment advisers could potentially rely on political relationships to maintain client relationships even in the face of suboptimal performance, thereby reducing their exposure to performance-based litigation risk. However, the regulatory prohibition forces advisers to compete solely on merit, creating a more transparent and performance-sensitive environment where poor outcomes are more likely to result in client defection and potential legal challenges (Francis et al., 1994; Tucker, 2007). This increased litigation exposure creates powerful incentives for enhanced voluntary disclosure, as advisers seek to demonstrate transparency, competence, and good faith efforts to inform clients about investment strategies, risks, and performance expectations, consistent with established theories linking litigation risk to disclosure quality.

The economic mechanism operates through advisers' rational response to increased litigation exposure by expanding voluntary disclosure to create legal safe harbors and demonstrate proactive risk management. Enhanced disclosure serves multiple defensive functions: it provides evidence of good faith communication with clients, establishes clear documentation of risk warnings and strategy explanations, and creates a paper trail that can be valuable in defending against potential litigation claims (Kim and Skinner, 2012; Rogers and Van Buskirk, 2009). This theoretical framework predicts that the elimination of political protection mechanisms should lead to measurably higher levels of voluntary disclosure as advisers adapt to the new competitive and legal environment by increasing transparency and communication with stakeholders.

Our empirical analysis reveals strong evidence supporting the litigation risk channel through which political contribution restrictions affect voluntary disclosure behavior. The baseline specification demonstrates a statistically significant negative treatment effect of -0.0830 (t-statistic = 8.40, $p < 0.001$), indicating that the elimination of pay-to-play practices led to a substantial reduction in disclosure levels, contrary to initial theoretical predictions but consistent with alternative explanations related to reduced regulatory scrutiny or changed competitive dynamics. However, when controlling for firm-specific characteristics including institutional ownership, size, book-to-market ratios, and performance metrics, the treatment effect becomes positive but statistically insignificant (coefficient = 0.0079, t-statistic = 0.55, $p = 0.580$), suggesting that firm characteristics play a crucial role in mediating the relationship between regulatory changes and disclosure behavior.

The most comprehensive specification, which includes both firm-level controls and fixed effects, yields a negative treatment effect of -0.0248 (t-statistic = 1.98, $p = 0.048$), indicating a modest but statistically significant decrease in voluntary disclosure following the regulatory intervention. This finding suggests that the elimination of political influence may have reduced rather than increased disclosure levels, potentially because advisers previously engaged in higher disclosure as part of relationship-building activities with politically connected clients, or because the new merit-based competition reduced the need for extensive voluntary disclosure when performance metrics became the primary evaluation criterion. The high R-squared of 0.8751 in this specification indicates strong explanatory power, with institutional ownership (coefficient = 0.0574) and firm size (coefficient = 0.0918, t-statistic = 8.27) emerging as the most economically significant predictors of disclosure behavior.

The control variables provide additional insights into the determinants of voluntary disclosure in the investment advisory context, with firm size consistently showing positive and highly significant effects across specifications, supporting established theories that larger firms face greater disclosure pressures due to enhanced visibility and stakeholder scrutiny. The negative coefficient on losses (-0.0730, t-statistic = -6.33) and the negative relationship with stock returns (-0.0344, t-statistic = -4.33) suggest that poor performance is associated with reduced voluntary disclosure, potentially reflecting managers' incentives to limit information flow during periods of underperformance. These findings collectively indicate that while litigation risk represents an important theoretical channel linking regulatory changes to disclosure behavior, the actual effects may be more complex and depend critically on the specific institutional context and competitive dynamics within the investment advisory industry.

This study contributes to several streams of literature examining the intersection of regulatory reform, political economy, and corporate disclosure practices. Our findings extend the work of Hochberg and Rauh (2013) on political connections in asset management by providing direct evidence of how the elimination of pay-to-play practices affects information production and disclosure behavior, while complementing Brown et al. (2021) by demonstrating that regulatory interventions can have counterintuitive effects on transparency depending on the underlying economic mechanisms. Unlike previous studies that focus primarily on the direct effects of political connections on performance or fund flows, we provide novel evidence on the indirect effects operating through the litigation risk channel, revealing that political contribution restrictions may actually reduce rather than increase voluntary disclosure levels.

The broader implications of our findings extend beyond the investment advisory industry to inform regulatory policy and theoretical understanding of how political economy factors influence corporate information environments. Our evidence suggests that policymakers should carefully consider the unintended consequences of regulatory interventions, as the elimination of political influence may not automatically lead to enhanced transparency if the underlying economic incentives favor reduced disclosure in the new competitive environment. These findings contribute to the growing literature on regulatory unintended consequences and highlight the importance of considering multiple transmission channels when evaluating the effects of financial sector reforms on market transparency and information production.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The SEC's Political Contributions by Investment Advisers rule, which became effective in September 2010 (though initially proposed in 2009), represents a significant regulatory intervention targeting pay-to-play practices in the investment advisory industry (SEC, 2010). This rule prohibits investment advisers from providing advisory services to government clients for compensation for two years after the adviser or certain of its executives make political contributions to officials of those government clients (Christoffersen et al., 2013). The regulation affects all SEC-registered investment advisers who provide or seek to provide investment advisory services to government entities, including state and local governments and their agencies, covering a substantial portion of the investment advisory industry that manages public pension funds and other government assets (Sensoy, 2009). The SEC instituted this change following widespread concerns about corruption and conflicts of interest in the selection of investment advisers by government entities, where political contributions appeared to influence adviser selection rather than merit-based criteria (Hochberg and Rauh, 2013).

The rule became effective on March 14, 2011, with a two-year lookback period that made it applicable to political contributions made after September 13, 2009 (SEC, 2010). Implementation required investment advisers to establish comprehensive compliance procedures, including pre-clearance of political contributions, maintenance of detailed records, and regular monitoring of covered associates' political activities (Bradley et al., 2016). The regulation also imposed disclosure requirements, mandating advisers to report political contributions quarterly and maintain records of all contributions made by the adviser and covered associates (Aggarwal et al., 2012). These implementation details created significant compliance costs and operational changes for affected firms, fundamentally altering the relationship between investment advisers and government clients.

This regulatory change occurred during a period of heightened securities regulation following the 2008 financial crisis, coinciding with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (Skinner, 2011). Other contemporaneous securities law adoptions included enhanced oversight of systemically important financial institutions, the Volcker Rule restricting proprietary trading, and increased disclosure requirements for executive compensation (Dechow et al., 2010). However, the Political Contributions by Investment Advisers rule stands distinct as it specifically targets the intersection of political activity and business relationships, creating a unique regulatory environment for examining how restrictions on political influence affect firm behavior and disclosure decisions (Kim and Skinner, 2012).

Theoretical Framework

The Political Contributions by Investment Advisers rule provides an ideal setting to examine voluntary disclosure decisions through the lens of litigation risk theory, as the regulation fundamentally altered the legal and regulatory environment in which investment advisers operate. Litigation risk theory posits that firms face potential legal consequences from various stakeholders, including shareholders, regulators, and clients, when their disclosures are inadequate, misleading, or when their business practices create legal vulnerabilities (Skinner, 1994). This theoretical framework suggests that managers make disclosure decisions by weighing the costs and benefits of transparency, with litigation risk serving as a primary driver of disclosure behavior.

Core concepts of litigation risk theory center on the premise that firms increase voluntary disclosure to reduce the probability of litigation and associated costs (Johnson et al., 2001). The theory identifies several key mechanisms through which litigation risk influences disclosure: information asymmetry reduction, regulatory compliance demonstration, and stakeholder relationship management (Francis et al., 1994). When litigation risk increases, firms typically respond by enhancing their disclosure practices to signal compliance, reduce information uncertainty, and demonstrate good governance practices to potential litigants and regulators. The theory also recognizes that litigation risk varies across firms and time periods based on regulatory changes, industry characteristics, and firm-specific factors.

In the context of voluntary disclosure decisions, litigation risk theory suggests that firms strategically adjust their disclosure practices in response to changes in their legal and regulatory environment (Kasznik and Lev, 1995). The Political Contributions by Investment Advisers rule created new compliance requirements and potential penalties for violations, effectively increasing the litigation risk faced by investment advisers and creating incentives for enhanced voluntary disclosure to demonstrate compliance and mitigate legal exposure.

Hypothesis Development

The Political Contributions by Investment Advisers rule created significant new litigation risks for investment advisers through multiple channels, establishing clear economic mechanisms linking the regulation to voluntary disclosure decisions. First, the rule introduced substantial penalties for violations, including the two-year prohibition on providing compensated advisory services to government clients, which could result in significant revenue losses for affected firms (Sensoy, 2009). Additionally, violations could trigger SEC enforcement actions, civil penalties, and potential criminal referrals, creating direct litigation exposure (Bradley et al., 2016). The rule also established detailed recordkeeping and reporting requirements, where failures to maintain adequate documentation or provide accurate disclosures could result in additional regulatory violations and associated legal consequences (Aggarwal et al., 2012). These enhanced penalties and compliance requirements fundamentally increased the litigation risk profile for investment advisers, creating strong incentives to demonstrate compliance through enhanced voluntary disclosure.

Established theoretical frameworks in litigation risk suggest that firms respond to increased regulatory scrutiny and potential legal exposure by expanding their voluntary disclosure practices (Skinner, 1994; Johnson et al., 2001). The regulatory compliance theory indicates that when firms face new regulatory requirements with significant penalties, they tend to over-disclose rather than under-disclose to signal compliance and reduce the probability of regulatory action (Francis et al., 1994). In the context of the Political Contributions rule, investment advisers face heightened scrutiny regarding their political activities and government relationships, creating incentives to voluntarily disclose information about their compliance procedures, governance practices, and risk management systems to demonstrate adherence to the new requirements (Kim and Skinner, 2012). Furthermore, signaling theory suggests that firms use voluntary disclosure to differentiate themselves from competitors and signal superior compliance and governance practices to government clients and other stakeholders (Dechow et al., 2010). Given the reputational risks associated with pay-to-play violations and the competitive nature of government advisory contracts, investment advisers have strong incentives to use voluntary disclosure as a mechanism to signal their commitment to ethical practices and regulatory compliance.

Prior literature provides consistent theoretical predictions regarding the relationship between increased litigation risk and voluntary disclosure, with limited evidence of competing theoretical frameworks. Studies examining regulatory changes and disclosure behavior consistently find that firms increase voluntary disclosure in response to heightened regulatory scrutiny and litigation risk (Skinner, 2011; Sensoy, 2009). The litigation risk literature suggests that the costs of under-disclosure (potential legal consequences, regulatory penalties, reputational damage) typically outweigh the costs of over-disclosure when firms face significant regulatory changes (Kasznik and Lev, 1995). In the specific context of investment advisers, the high-stakes nature of government contracts and the reputational sensitivity of pay-to-play issues create particularly strong incentives for enhanced voluntary disclosure (Hochberg and Rauh, 2013). The theoretical framework therefore suggests a unidirectional relationship where increased litigation risk from the Political Contributions rule leads to expanded voluntary disclosure practices among affected investment advisers.

H1: Investment advisers increase voluntary disclosure following the implementation of the Political Contributions by Investment Advisers rule due to increased litigation risk.

RESEARCH DESIGN

Sample Selection and Regulatory Context

Our analysis examines the impact of the SEC's 2009 Political Contributions by Investment Advisers regulation on voluntary disclosure through the risk channel. The regulation, implemented by the Securities and Exchange Commission, prohibited pay-to-play practices by investment advisers, effectively eliminating political influence in adviser selection processes. While this regulation directly targeted investment advisory practices, we examine its broader market-wide effects by analyzing all firms in the Compustat universe during our sample period, consistent with prior research examining economy-wide regulatory changes (Kedia and Rajgopal, 2011; Iliev, 2010). Our treatment variable affects all firms in the sample, as the regulatory change altered the overall information environment and risk assessment practices across capital markets. This comprehensive approach allows us to capture both direct and indirect effects of the regulation on corporate disclosure behavior.

Model Specification

We employ a pre-post research design to examine the relationship between the Political Contributions by Investment Advisers regulation and voluntary disclosure frequency through the risk channel. Our empirical model follows established frameworks in the voluntary disclosure literature (Beyer et al., 2010; Healy and Palepu, 2001) and is specified as follows:

$$\text{FreqMF} = \beta_0 + \beta_1\text{Treatment Effect} + \gamma\text{Controls} + \varepsilon$$

The model incorporates control variables established in prior literature as determinants of voluntary disclosure decisions. We include institutional ownership, firm size, book-to-market ratio, return on assets, stock returns, earnings volatility, loss indicator, and class action litigation risk, following the framework established by Ajinkya et al. (2005) and Rogers and Stocken (2005). These variables capture firm-specific characteristics that influence managers' incentives to provide voluntary guidance and are particularly relevant for understanding disclosure decisions through the risk channel.

Our research design addresses potential endogeneity concerns inherent in voluntary disclosure studies by exploiting the exogenous nature of the regulatory change. The timing and implementation of the Political Contributions by Investment Advisers regulation was determined by regulatory authorities rather than firm-specific factors, providing a quasi-experimental setting that mitigates concerns about reverse causality and omitted variable bias (Bertrand and Mullainathan, 2003). Additionally, we include a comprehensive set of control variables and employ multiple model specifications to ensure the robustness of our findings.

Variable Definitions

Our dependent variable, FreqMF, measures management forecast frequency and captures the extent of voluntary disclosure provided by firm management. This variable is widely used in the voluntary disclosure literature as a proxy for managers' willingness to communicate with capital markets (Hirst et al., 2008; Beyer et al., 2010). The Treatment Effect variable is an indicator variable equal to one for the post-regulation period from 2009 onwards, and zero otherwise, capturing the market-wide impact of the Political Contributions by Investment Advisers regulation on all firms in our sample.

Our control variables follow established measures from prior research. Institutional ownership (linstown) captures the monitoring role of institutional investors and their demand for information, with higher institutional ownership typically associated with increased voluntary disclosure (Ajinkya et al., 2005). Firm size (lsize) controls for the scale of operations and information environment complexity, with larger firms generally providing more frequent guidance. Book-to-market ratio (lbtm) captures growth opportunities and valuation uncertainty, while return on assets (lroa) measures operational performance. Stock return (lsaret12) controls for recent market performance, and earnings volatility (levol) captures the uncertainty in firm performance. The loss indicator (lloss) identifies firms with negative earnings, and class action litigation risk (lcalrisk) measures legal exposure, both of which significantly influence disclosure incentives through the risk channel (Rogers and Stocken, 2005; Skinner, 1994).

These control variables are particularly relevant for understanding disclosure behavior through the risk channel, as they capture various dimensions of firm risk, information asymmetry, and litigation exposure that influence managers' cost-benefit calculations regarding voluntary disclosure. The inclusion of these variables allows us to isolate the specific impact of the regulatory change while controlling for other factors that may affect disclosure frequency.

Sample Construction

We construct our sample using a five-year window centered around the 2009 implementation of the Political Contributions by Investment Advisers regulation, spanning two years before and two years after the regulatory change. The post-regulation period includes 2009 onwards, allowing us to capture both immediate and longer-term effects of the regulatory change on voluntary disclosure behavior. This event window is consistent with prior studies examining regulatory changes in financial markets and provides sufficient observations to identify treatment effects while minimizing confounding events (Gao et al., 2009; Iliev, 2010).

Our data comes from multiple sources to ensure comprehensive coverage of firm characteristics and disclosure behavior. We obtain financial statement data from Compustat, management forecast data from I/B/E/S, audit-related information from Audit Analytics, and stock return data from CRSP. This multi-source approach follows established practices in the accounting literature and ensures data quality and completeness (Beyer et al., 2010; Healy and Palepu, 2001). We merge these databases using standard identifiers and apply appropriate data filters to ensure consistency across sources.

The final sample consists of 16,882 firm-year observations representing all firms in the Compustat universe during our sample period. In our research design, all firms serve as the treatment group in the post-regulation period, as the Political Contributions by Investment Advisers regulation created market-wide changes in the information environment and risk assessment practices. The pre-regulation period serves as the baseline for comparison, allowing us to identify changes in disclosure behavior attributable to the regulatory intervention. We apply standard sample restrictions including the availability of required financial data and the exclusion of financial institutions and utilities where appropriate, consistent with prior voluntary disclosure research (Rogers and Stocken, 2005; Ajinkya et al., 2005).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 16,882 firm-year observations from 4,386 unique firms over the period 2007 to 2011. This panel dataset provides comprehensive coverage of the regulatory environment surrounding political contributions by investment advisers and associated litigation risk during a critical period of financial market reform.

We examine several key firm characteristics that capture institutional ownership, firm size, valuation, and performance metrics. Institutional ownership (linstown) exhibits substantial variation across our sample, with a mean of 0.569 and standard deviation of 0.318. The distribution spans from minimal institutional presence (0.001) to concentrated institutional ownership exceeding 100 percent (1.110), consistent with prior literature documenting significant heterogeneity in institutional investor participation. The median institutional ownership of 0.618 suggests that institutional investors hold majority stakes in most sample firms.

Firm size (lsize) shows considerable dispersion, with a mean of 5.987 and standard deviation of 2.060, indicating our sample encompasses firms ranging from small-cap to large-cap entities. The book-to-market ratio (lbtm) averages 0.663 with notable right skewness, as evidenced by the mean exceeding the median (0.531). This distribution is consistent with the presence of distressed firms exhibiting high book-to-market ratios.

Profitability measures reveal challenging operating conditions during our sample period. Return on assets (lroa) exhibits a negative mean of -0.044, though the median remains positive at 0.021, suggesting that while the average firm experienced losses, the typical firm maintained modest profitability. Similarly, stock returns (lsaret12) average -0.018 with substantial volatility (standard deviation of 0.494), reflecting the turbulent market conditions following the 2008 financial crisis.

The loss indicator (lloss) shows that 33.5 percent of firm-year observations report negative earnings, highlighting the prevalence of financial distress during our sample period. Earnings volatility (levol) and litigation risk (lcalrisk) demonstrate considerable cross-sectional variation, with means of 0.147 and 0.317, respectively.

Our treatment variables indicate that 58.2 percent of observations occur in the post-law period, providing balanced representation across the regulatory change. The mutual fund frequency variable (freqMF) exhibits substantial variation with a mean of 0.601 and standard deviation of 0.895, suggesting heterogeneous exposure to mutual fund investment activity across sample firms. These descriptive statistics collectively indicate a well-distributed sample that captures meaningful variation in firm characteristics, institutional ownership patterns, and regulatory exposure during a pivotal period in financial market regulation.

RESULTS

Regression Analysis

We examine the association between the implementation of the Political Contributions by Investment Advisers rule and voluntary disclosure behavior using three empirical specifications. Our most robust specification (3), which includes firm fixed effects and control variables, reveals a statistically significant negative treatment effect of -0.0248 (t-statistic = -1.98, p-value = 0.0482). This finding indicates that investment advisers subject to the Political Contributions rule decreased their voluntary disclosure following the regulation's implementation, contrary to our theoretical prediction. The coefficient suggests that treated firms reduced their voluntary disclosure by approximately 2.48 percentage points relative to control firms. While this effect is statistically significant at the 5% level, the economic magnitude is relatively modest, representing a small but meaningful reduction in disclosure behavior. The high R-squared of 0.8751 in our preferred specification indicates that our model explains a substantial portion of the variation in voluntary disclosure, lending confidence to our empirical approach.

The comparison across model specifications reveals important insights about the robustness of our findings and the importance of controlling for firm-specific heterogeneity. Specification (1), which excludes both control variables and fixed effects, shows a large negative treatment effect of -0.0830 (t-statistic = -8.40), but explains minimal variation in the dependent variable (R-squared = 0.0021). Specification (2) incorporates control variables but omits firm fixed effects, yielding an economically and statistically insignificant positive coefficient of 0.0079 (t-statistic = 0.55, p-value = 0.5796). The dramatic change in both magnitude and sign between specifications (1) and (2) suggests that omitted variable bias significantly affects the treatment effect estimate when control variables are excluded. However, the inclusion of firm fixed effects in specification (3) again produces a negative and statistically significant treatment effect, though smaller in magnitude than specification (1).

This pattern indicates that unobserved firm-specific characteristics play a crucial role in determining voluntary disclosure behavior, and their omission can lead to misleading inferences about the regulatory impact.

The control variables in our preferred specification generally align with established findings in the voluntary disclosure literature, supporting the validity of our empirical approach. Firm size (lsize) exhibits a positive and highly significant coefficient of 0.0918 (t-statistic = 8.27), consistent with prior research showing that larger firms engage in more extensive voluntary disclosure due to greater analyst following and investor demand for information. The negative coefficient on stock returns (lsaret12) of -0.0344 (t-statistic = -4.33) supports the bad news disclosure hypothesis, where firms with poor performance increase disclosure to explain unfavorable outcomes. Loss firms (lloss) show significantly lower voluntary disclosure levels, with a coefficient of -0.0730 (t-statistic = -6.33), consistent with managers' incentives to withhold information during periods of poor performance. Notably, institutional ownership (linstown) becomes statistically insignificant in the firm fixed effects specification, suggesting that the cross-sectional association between institutional ownership and disclosure is primarily driven by time-invariant firm characteristics rather than within-firm variation. These results contradict our hypothesis H1, which predicted that investment advisers would increase voluntary disclosure following the Political Contributions rule implementation due to heightened litigation risk. Instead, we find evidence of a significant decrease in voluntary disclosure, suggesting that the regulatory change may have created incentives for reduced transparency rather than enhanced disclosure. This unexpected finding challenges the conventional wisdom that increased litigation risk uniformly leads to greater voluntary disclosure and highlights the complex relationship between regulatory changes and firm disclosure behavior in the investment advisory industry.

CONCLUSION

This study examines whether the 2009 Political Contributions by Investment Advisers rule, which prohibited pay-to-play practices in adviser selection, influenced corporate voluntary disclosure through a risk channel. We investigate whether firms responded to the elimination of political influence in investment adviser selection by adjusting their disclosure practices to manage perceived risk. Our empirical analysis exploits the exogenous regulatory shock provided by this rule to identify causal effects on voluntary disclosure behavior.

Our findings reveal nuanced effects that depend critically on model specification and the inclusion of control variables. In our baseline specification without controls, we document a statistically significant negative treatment effect of -0.083 (t-statistic = 8.40), suggesting that firms subject to the regulation decreased voluntary disclosure following the rule's implementation. However, when we incorporate standard firm-level control variables, this effect becomes statistically insignificant (coefficient = 0.0079, t-statistic = 0.55), indicating that firm characteristics explain much of the observed variation in disclosure behavior. Most notably, our most comprehensive specification with firm fixed effects yields a negative and statistically significant treatment effect of -0.025 (t-statistic = 1.98, p-value = 0.048), suggesting a modest but meaningful reduction in voluntary disclosure following the regulatory change. The substantial increase in R-squared from 0.002 to 0.875 across specifications underscores the importance of controlling for firm heterogeneity and unobserved characteristics when examining disclosure responses to regulatory interventions.

The economic magnitude of our findings, while statistically significant, suggests relatively modest effects on voluntary disclosure practices. The treatment effect of -0.025 in our preferred specification represents approximately a 2.5 percentage point decrease in disclosure propensity, which is economically meaningful given the baseline levels of voluntary disclosure in our sample. These results are consistent with firms reducing disclosure transparency when political channels for influencing investment adviser selection are eliminated, potentially reflecting increased uncertainty about investor relations and capital allocation processes. The risk channel mechanism we propose suggests that firms may have perceived the regulatory change as increasing information asymmetry costs, leading to more conservative disclosure strategies.

Our findings carry important implications for regulators seeking to understand the unintended consequences of financial market reforms. The Political Contributions by Investment Advisers rule successfully eliminated direct political influence in adviser selection, but our evidence suggests it may have inadvertently reduced corporate transparency. Regulators should consider these disclosure effects when designing future reforms targeting political influence in financial markets, as reduced voluntary disclosure can impair market efficiency and increase information asymmetries between firms and investors (Healy and Palepu, 2001; Beyer et al., 2010). For corporate managers, our results highlight the interconnected nature of political, regulatory, and disclosure strategies. Managers appear to view changes in the political landscape of investment adviser selection as relevant to their disclosure decisions, suggesting that disclosure policies should be evaluated holistically rather than in isolation from broader stakeholder relationship management.

From an investor perspective, our findings suggest that regulatory reforms targeting political influence may have subtle but meaningful effects on information availability. Investors should be aware that firms may adjust disclosure practices in response to changes in the political economy of capital markets, even when such changes do not directly target disclosure requirements. Our results contribute to the growing literature on the political economy of corporate disclosure (Correia, 2014; Chen et al., 2018) and extend research on how regulatory changes in one domain can generate spillover effects in corporate reporting behavior. The risk channel we document adds to our understanding of how firms perceive and respond to regulatory uncertainty through their information disclosure strategies.

Our study has several important limitations that suggest avenues for future research. First, while we exploit the exogenous nature of the regulatory change, we cannot definitively rule out contemporaneous factors that might have influenced both the regulatory environment and corporate disclosure practices. Second, our measure of voluntary disclosure, while comprehensive, may not capture all forms of corporate communication that firms use to manage information asymmetries and stakeholder relationships. Future research could examine specific types of disclosure, such as management forecasts or conference call frequency, to better understand which disclosure channels are most sensitive to political economy changes.

The risk channel mechanism we propose warrants further investigation through more direct measures of firm-level risk perceptions and investor uncertainty. Future studies could examine whether the disclosure effects we document vary systematically with firm characteristics such as political connections, institutional ownership concentration, or geographic proximity to regulatory centers. Additionally, researchers could explore whether similar disclosure responses occur following other regulatory changes that alter the political economy of capital markets, such as lobbying restrictions or campaign finance reforms. Understanding the broader applicability of the risk channel mechanism would enhance our knowledge of how political and regulatory factors influence corporate transparency decisions and ultimately market efficiency.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	16,882	0.6006	0.8947	0.0000	0.0000	1.6094
Treatment Effect	16,882	0.5816	0.4933	0.0000	1.0000	1.0000
Institutional ownership	16,882	0.5693	0.3181	0.2894	0.6178	0.8399
Firm size	16,882	5.9867	2.0604	4.4840	5.9405	7.3840
Book-to-market	16,882	0.6628	0.6480	0.2937	0.5306	0.8603
ROA	16,882	-0.0443	0.2563	-0.0330	0.0211	0.0666
Stock return	16,882	-0.0180	0.4940	-0.3085	-0.1019	0.1465
Earnings volatility	16,882	0.1467	0.2842	0.0233	0.0568	0.1477
Loss	16,882	0.3348	0.4719	0.0000	0.0000	1.0000
Class action litigation risk	16,882	0.3171	0.2891	0.0889	0.2078	0.4755
Time Trend	16,882	1.9297	1.4063	1.0000	2.0000	3.0000

This table shows the descriptive statistics. All continuous variables are winsorized at the 1st and 99th percentiles.

Table 2
Pearson Correlations
Political Contributionsby Investment Advisers Litigation Risk

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	**-0.05**	-0.01	**-0.07**	**0.20**	**-0.05**	0.00	**-0.02**	**0.10**	**0.27**
FreqMF	**-0.05**	1.00	**0.43**	**0.44**	**-0.15**	**0.23**	-0.01	**-0.15**	**-0.27**	-0.01
Institutional ownership	-0.01	**0.43**	1.00	**0.63**	**-0.15**	**0.28**	**-0.10**	**-0.22**	**-0.23**	**0.06**
Firm size	**-0.07**	**0.44**	**0.63**	1.00	**-0.35**	**0.36**	**0.03**	**-0.25**	**-0.40**	**0.12**
Book-to-market	**0.20**	**-0.15**	**-0.15**	**-0.35**	1.00	**0.04**	**-0.21**	**-0.13**	**0.14**	**-0.08**
ROA	**-0.05**	**0.23**	**0.28**	**0.36**	**0.04**	1.00	**0.12**	**-0.54**	**-0.59**	**-0.08**
Stock return	0.00	-0.01	**-0.10**	**0.03**	**-0.21**	**0.12**	1.00	0.01	**-0.14**	**0.04**
Earnings volatility	**-0.02**	**-0.15**	**-0.22**	**-0.25**	**-0.13**	**-0.54**	0.01	1.00	**0.33**	**0.13**
Loss	**0.10**	**-0.27**	**-0.23**	**-0.40**	**0.14**	**-0.59**	**-0.14**	**0.33**	1.00	**0.14**
Class action litigation risk	**0.27**	-0.01	**0.06**	**0.12**	**-0.08**	**-0.08**	**0.04**	**0.13**	**0.14**	1.00

This table shows the Pearson correlations for the sample. Correlations that are significant at the 0.05 level or better are highlighted in bold.

Table 3

The Impact of Political Contributions by Investment Advisers on Management Forecast Frequency

	(1)	(2)	(3)
Treatment Effect	-0.0830*** (8.40)	0.0079 (0.55)	-0.0248** (1.98)
Institutional ownership		0.7140*** (15.02)	0.0574 (1.10)
Firm size		0.1024*** (11.01)	0.0918*** (8.27)
Book-to-market		-0.0307** (2.31)	0.0039 (0.38)
ROA		0.0452 (1.40)	0.0405* (1.90)
Stock return		-0.0236** (2.19)	-0.0344*** (4.33)
Earnings volatility		0.0288 (0.90)	-0.0092 (0.24)
Loss		-0.1942*** (9.93)	-0.0730*** (6.33)
Class action litigation risk		-0.1331*** (4.70)	-0.0052 (0.33)
Time Trend		-0.0033 (0.62)	-0.0140*** (3.27)
Firm fixed effects	No	No	Yes
N	16,882	16,882	16,882
R^2	0.0021	0.2465	0.8751

Notes: t-statistics in parentheses. *, **, and *** represent significance at the 10%, 5%, and 1% level, respectively.