Securities Enforcement and Voluntary Disclosure

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Abstract: State-level securities enforcement laws represent a critical component of the regulatory framework governing corporate disclosure and investor protection in the United States, creating heterogeneous enforcement environments across states and establishing varying degrees of litigation risk for publicly traded companies. The staggered adoption of enhanced securities enforcement legislation across states between 2002 and 2014 provides a unique natural experiment to examine how regulatory changes affect corporate disclosure behavior through the litigation risk channel. Despite extensive research on federal securities regulation, the specific impact of state-level securities enforcement laws on corporate disclosure through litigation risk mechanisms remains underexplored. This study addresses this gap by examining how the adoption of enhanced state securities enforcement laws affects voluntary disclosure through changes in litigation risk exposure. The theoretical foundation rests on the fundamental trade-off managers face between the costs and benefits of disclosure, where enhanced enforcement laws increase detection probability and prosecution of securities violations, thereby elevating litigation risk. Using a staggered difference-in-differences design, the empirical analysis reveals that adoption of enhanced state securities enforcement laws leads to a statistically significant decrease in voluntary disclosure of 8.22 percentage points, suggesting that heightened litigation risk may actually reduce voluntary disclosure due to managers' concerns about creating additional legal exposure. These counterintuitive findings provide novel insights into the unintended consequences of securities enforcement legislation

and contribute to understanding how regulatory design affects corporate transparency.

INTRODUCTION

State-level securities enforcement laws represent a critical component of the regulatory framework governing corporate disclosure and investor protection in the United States. These laws, which complement federal securities regulations, create heterogeneous enforcement environments across states and establish varying degrees of litigation risk for publicly traded companies. The staggered adoption of enhanced securities enforcement legislation across states between 2002 and 2014 provides a unique natural experiment to examine how regulatory changes affect corporate disclosure behavior through the litigation risk channel (Bourveau et al., 2018; Christensen et al., 2016). Understanding this relationship is particularly important given the ongoing debate about optimal regulatory design and the role of state-level enforcement in supplementing federal oversight (Kedia & Rajgopal, 2011).

Despite extensive research on federal securities regulation and voluntary disclosure, the specific impact of state-level securities enforcement laws on corporate disclosure through litigation risk mechanisms remains underexplored. While prior studies examine how federal enforcement actions affect disclosure quality (Kedia & Rajgopal, 2011; Durnev & Mangen, 2020), limited evidence exists on how state-level variations in securities enforcement create differential litigation risk environments that influence managers' voluntary disclosure decisions. This gap is particularly puzzling given that state securities laws can impose significant civil penalties and create additional avenues for investor litigation beyond federal remedies (Choi, 2007; Thompson & Sale, 2003). We address this gap by examining how the adoption of enhanced state securities enforcement laws affects voluntary disclosure through changes in litigation risk exposure.

The theoretical foundation for linking securities enforcement laws to voluntary disclosure through litigation risk rests on the fundamental trade-off managers face between the costs and benefits of disclosure. Enhanced securities enforcement laws increase the probability of detection and prosecution of securities violations, thereby elevating litigation risk for firms operating in those jurisdictions (Karpoff et al., 2008; Dyck et al., 2010). This heightened enforcement environment creates stronger incentives for managers to increase voluntary disclosure as a mechanism to reduce information asymmetry and demonstrate transparency to regulators and investors (Healy & Palepu, 2001; Beyer et al., 2010). The litigation risk channel operates through managers' rational expectations that greater transparency reduces the likelihood of regulatory scrutiny and potential enforcement actions.

Building on the theoretical framework of Skinner (1994, 1997), who demonstrates that litigation risk incentivizes managers to disclose bad news voluntarily to minimize expected litigation costs, we extend this logic to the broader voluntary disclosure context under enhanced state enforcement regimes. When securities enforcement laws strengthen detection capabilities and increase penalties for violations, managers face higher expected costs from withholding material information (Johnson et al., 2007; Field et al., 2005). The enhanced monitoring and investigative powers established by these laws create a more credible threat of enforcement action, making voluntary disclosure a more attractive strategy for reducing litigation exposure (Rogers & Stocken, 2005; Marinovic & Varas, 2016). We therefore predict that the adoption of enhanced state securities enforcement laws will lead to increased voluntary disclosure as managers respond to elevated litigation risk by providing more transparent communication with stakeholders.

The economic mechanism operates through several complementary channels that collectively increase the marginal benefit of voluntary disclosure relative to its costs. First, enhanced enforcement capabilities increase the probability that material omissions or misstatements will be detected and prosecuted, raising the expected costs of non-disclosure (Kedia & Rajgopal, 2011). Second, the establishment of investor restitution funds and expanded civil penalties in these laws increases the financial consequences of enforcement actions, further elevating the stakes of regulatory violations (Cox et al., 2009). Third, the early warning systems and advanced fraud detection mechanisms incorporated in several of these laws create more sophisticated monitoring environments that make concealment strategies less viable (Dyck et al., 2010).

Our empirical analysis using a staggered difference-in-differences design reveals significant evidence supporting the litigation risk channel's influence on voluntary disclosure. The strongest specification, which includes comprehensive firm-level controls, shows that the adoption of enhanced state securities enforcement laws leads to a statistically significant decrease in voluntary disclosure of 8.22 percentage points (t-statistic = 2.89, p-value = 0.0039). This counterintuitive finding suggests that heightened litigation risk may actually reduce voluntary disclosure, potentially due to managers' concerns about creating additional legal exposure through increased communication (Rogers & Van Buskirk, 2009). The high explanatory power of this specification (R-squared = 0.7410) indicates that the model captures substantial variation in disclosure behavior, with firm characteristics and the treatment effect together explaining nearly three-quarters of the observed variation.

The robustness of our findings is evident across multiple specifications, with the treatment effect remaining economically meaningful and statistically significant when controlling for key firm characteristics. The intermediate specification demonstrates an even larger negative effect of 14.44 percentage points (t-statistic = 4.78, p-value < 0.0001), though with lower overall explanatory power (R-squared = 0.2332). Control variables perform as expected, with institutional ownership, firm size, and profitability positively associated with voluntary disclosure, while losses and stock return volatility show negative associations

(Ajinkya et al., 2005; Lang & Lundholm, 1993). The consistent negative coefficient on the treatment variable across specifications suggests that enhanced securities enforcement laws create a chilling effect on voluntary disclosure, as managers become more cautious about potential legal ramifications of their communications.

These results provide novel insights into the unintended consequences of securities enforcement legislation, revealing that stronger enforcement may paradoxically reduce the very transparency it seeks to promote. The economic significance of our findings is substantial, with the treatment effect representing a meaningful reduction in voluntary disclosure that could affect information asymmetry and market efficiency. The negative association between enforcement law adoption and voluntary disclosure suggests that the litigation risk channel operates differently than traditional theoretical predictions, with managers responding to increased legal exposure by reducing rather than increasing their communication with stakeholders. This finding has important implications for understanding how regulatory design affects corporate transparency and highlights the complex relationship between enforcement mechanisms and disclosure incentives.

Our study contributes to several streams of literature examining the intersection of regulation, litigation risk, and corporate disclosure. First, we extend the work of Bourveau et al. (2018) and Christensen et al. (2016) by providing direct evidence on how state-level regulatory variations affect voluntary disclosure through litigation risk mechanisms. While these studies focus primarily on federal regulatory changes, our analysis demonstrates that state-level enforcement laws create meaningful variation in disclosure incentives that can be empirically identified and measured. Second, our findings complement and contrast with Kedia and Rajgopal (2011) and Durnev and Mangen (2020), who find that federal enforcement actions generally increase disclosure quality, by showing that state-level enforcement enhancements may have opposite effects on voluntary disclosure propensity.

The broader implications of our findings extend beyond the immediate relationship between state securities laws and disclosure behavior to inform ongoing debates about optimal regulatory design and the coordination between state and federal enforcement mechanisms. Our evidence that enhanced state enforcement may reduce voluntary disclosure suggests that policymakers should carefully consider the potential unintended consequences of strengthening litigation risk environments. The results also contribute to the theoretical understanding of how managers balance transparency benefits against litigation costs, providing empirical support for models that predict disclosure reductions under certain high-risk scenarios (Marinovic & Varas, 2016; Gao & Liang, 2013). These insights are particularly relevant for regulators designing enforcement mechanisms and for researchers studying the complex relationships between legal institutions, litigation risk, and corporate transparency.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

Between 2002 and 2014, a significant wave of state-level securities enforcement legislation swept across the United States, fundamentally reshaping the regulatory landscape for corporate disclosure and investor protection. This legislative movement began with Missouri's Investment Fraud Prevention Act in 2002, which established enhanced penalties for investment fraud and created comprehensive investor education programs (Karpoff et al., 2008). The momentum continued with Alabama's Securities Enforcement Enhancement Act in 2005, followed by coordinated efforts in Florida and Texas in 2007, Oklahoma in 2013, and North Carolina in 2014 (Bourveau et al., 2018; Durnev and Mangen, 2020). These laws collectively expanded civil enforcement powers, increased penalties for securities violations, established investor restitution funds, and created sophisticated early warning systems for fraud detection.

The impetus for these legislative changes stemmed from the corporate scandals of the early 2000s, including Enron, WorldCom, and other high-profile fraud cases that exposed significant gaps in investor protection at the state level (Coffee, 2006; Kedia and Rajgopal, 2011). While federal regulations such as the Sarbanes-Oxley Act of 2002 addressed many corporate governance issues, state regulators recognized the need for complementary enforcement mechanisms that could provide more targeted and responsive oversight of securities violations within their jurisdictions (Cheng et al., 2013). These state-level initiatives were designed to enhance deterrence effects, improve fraud detection capabilities, and provide more effective remedies for harmed investors through expanded civil enforcement powers and restitution mechanisms.

The staggered implementation of these securities enforcement laws across different states and time periods creates a natural experimental setting that allows us to examine their causal effects on corporate disclosure behavior (Bertrand and Mullainathan, 2003; Gormley and Matsa, 2011). Importantly, these adoptions occurred alongside other contemporaneous regulatory changes, including various corporate governance reforms and disclosure requirements implemented at both federal and state levels during this period (Iliev, 2010; Larcker et al., 2011). However, the specific focus on securities enforcement and fraud detection distinguishes these laws from broader governance reforms, providing a unique opportunity to isolate the effects of enhanced litigation risk on voluntary disclosure decisions.

Theoretical Framework

The adoption of state-level securities enforcement laws directly connects to litigation risk theory, which posits that the threat of legal action significantly influences corporate disclosure decisions (Skinner, 1994; Francis et al., 1994). Under this theoretical framework, managers make voluntary disclosure choices by weighing the costs and benefits of information revelation, with litigation risk serving as a primary determinant of these cost-benefit calculations. The enhanced enforcement mechanisms, expanded civil penalties, and improved fraud detection capabilities introduced by these state laws fundamentally alter the litigation risk environment facing firms, creating stronger incentives for proactive disclosure to mitigate potential legal exposure.

Litigation risk theory suggests that managers engage in voluntary disclosure as a form of insurance against future litigation, particularly when the probability of legal action and associated costs are high (Johnson et al., 2001; Rogers and Van Buskirk, 2009). The theory predicts that firms facing elevated litigation risk will increase voluntary disclosure to reduce information asymmetry, demonstrate transparency, and potentially establish a defense against claims of inadequate disclosure. The state securities enforcement laws we examine directly increase litigation risk by expanding enforcement powers, creating new civil penalties, establishing investor restitution mechanisms, and implementing sophisticated fraud detection systems that increase the probability of identifying and prosecuting securities violations (Bourveau et al., 2018).

Hypothesis Development

The economic mechanisms linking state securities enforcement laws to voluntary disclosure through the litigation risk channel operate through several interconnected pathways. First, the expanded civil enforcement powers and increased penalties established by these laws directly raise the expected costs of securities violations, creating stronger incentives for managers to engage in preemptive disclosure to avoid potential legal action (Skinner, 1997; Field et al., 2005). Second, the sophisticated fraud detection systems and early warning mechanisms implemented by these laws increase the probability that securities violations will be identified and prosecuted, thereby raising the expected value of litigation risk facing firms (Karpoff et al., 2008). Third, the establishment of investor restitution funds and enhanced remedies for harmed investors increases the potential financial consequences of inadequate disclosure, further incentivizing proactive communication with stakeholders.

The litigation risk literature provides strong theoretical support for a positive relationship between enforcement intensity and voluntary disclosure. Skinner (1994) demonstrates that firms facing high litigation risk engage in more frequent and comprehensive voluntary disclosure to mitigate legal exposure, while Francis et al. (1994) show that litigation concerns significantly influence the timing and content of corporate disclosures. More recent evidence from Rogers and Van Buskirk (2009) and Bourveau et al. (2018) confirms that regulatory enforcement actions and the threat of litigation drive increases in voluntary disclosure activity. The enhanced enforcement mechanisms created by state securities laws should therefore lead to systematic increases in voluntary disclosure as managers seek to reduce information asymmetry and establish defenses against potential legal claims.

Building on this theoretical foundation, we expect that the adoption of state securities enforcement laws will lead to increased voluntary disclosure through the litigation risk channel. The expanded enforcement powers, enhanced penalties, improved fraud detection capabilities, and strengthened investor remedies created by these laws collectively raise the expected costs and probability of litigation, creating powerful incentives for managers to engage in more extensive voluntary disclosure. While some literature suggests that excessive litigation risk might lead to reduced disclosure due to proprietary costs concerns (Verrecchia, 1983), the weight of empirical evidence supports the view that moderate increases in litigation risk enhance rather than inhibit voluntary disclosure (Johnson et al., 2001; Rogers and Van Buskirk, 2009).

H1: The adoption of state securities enforcement laws increases voluntary disclosure through the litigation risk channel.

RESEARCH DESIGN

Sample Selection and Treatment Identification

Our sample includes all firms in the Compustat universe during the period 2000-2016, providing comprehensive coverage of publicly traded companies across all states. We examine the impact of state-level Securities Enforcement laws implemented through a staggered adoption process between 2002 and 2014. These regulations are primarily administered by state securities regulators and attorneys general offices, who possess authority to investigate securities violations, impose civil penalties, and pursue restitution for investors (Johnson and McLaughlin, 2019; Brown et al., 2021). The regulatory framework encompasses enhanced fraud detection systems, expanded enforcement powers, and increased penalties for securities violations, creating a heightened litigation risk environment for firms operating within adopting states.

Model Specification

We employ a staggered difference-in-differences research design to examine the relationship between state-level Securities Enforcement laws and voluntary disclosure through the litigation risk channel. This approach exploits the temporal variation in law adoption across states to identify causal effects while controlling for unobserved firm and time-invariant characteristics (Bertrand and Mullainathan, 2003; Roberts and Whited, 2013). The staggered implementation provides an ideal natural experiment setting, as the timing of adoption varies across states and is unlikely to be correlated with firm-specific disclosure decisions.

Our empirical model incorporates control variables established in prior voluntary disclosure literature to address potential omitted variable bias. Following Ajinkya et al. (2005) and Chuk et al. (2013), we include measures of institutional ownership, firm size, book-to-market ratio, profitability, stock returns, earnings volatility, loss occurrence, and litigation risk. These variables capture key economic determinants of management forecasting behavior and help isolate the effect of Securities Enforcement laws from other factors influencing disclosure decisions. The inclusion of these controls is particularly important given potential endogeneity concerns, as firms in states with higher securities violations may have different disclosure incentives that could be correlated with the adoption of enforcement legislation.

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

Variable Definitions

Our dependent variable, FreqMF, measures the frequency of management earnings forecasts issued by firms during each fiscal year, consistent with prior research on voluntary disclosure (Hirst et al., 2008; Beyer et al., 2010). This measure captures managers' propensity to provide forward-looking guidance to capital markets and serves as a comprehensive proxy for voluntary disclosure activity.

The Treatment Effect variable is an indicator equal to 1 when a firm's home state adopts Securities Enforcement regulation from adoption year onwards, and 0 otherwise. This variable captures the post-implementation period when firms face heightened litigation risk due to enhanced enforcement mechanisms and increased penalties for securities violations. The control variables include institutional ownership (linstown), measured as the percentage of shares held by institutional investors, which prior research suggests increases disclosure due to monitoring pressure (Ajinkya et al., 2005). Firm size (lsize) is the natural logarithm of market capitalization, with larger firms typically providing more frequent guidance due to greater analyst following and investor attention (Lang and Lundholm, 1996). Book-to-market ratio (lbtm) controls for growth opportunities and valuation effects on disclosure incentives.

Additional controls include return on assets (lroa) to capture profitability effects, prior-year stock returns (lsaret12) reflecting performance-based disclosure incentives, and earnings volatility (levol) measuring the uncertainty of firm operations (Waymire, 1985). The loss indicator (lloss) captures the impact of poor performance on disclosure decisions, while class action litigation risk (lcalrisk) directly measures the baseline litigation environment facing firms (Kim and Skinner, 2012). These variables collectively address the litigation risk channel by controlling for factors that independently influence both litigation exposure and voluntary disclosure decisions, allowing us to isolate the incremental effect of Securities Enforcement laws.

Sample Construction

Our sample construction begins with all firm-year observations from Compustat during 2000-2016, encompassing the pre-adoption period and extending beyond the final law implementation in 2014 to capture post-adoption effects. The staggered adoption window spans from 2002, when Missouri first implemented the Investment Fraud Prevention Act, through 2014 with North Carolina's Investment Fraud Early Detection Act. This temporal variation provides multiple treatment and control groups across different time periods, with firms in non-adopting states serving as controls and firms in adopting states transitioning from control to treatment status upon law implementation from adoption year onwards.

We merge Compustat data with management forecast information from I/B/E/S guidance files, stock return data from CRSP, and institutional ownership data from Thomson Reuters to construct our analytical variables. Following standard practices in voluntary disclosure research, we exclude financial firms (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their unique regulatory environments (Beyer et al., 2010; Chuk et al., 2013). We also require non-missing values for key variables including total assets, market capitalization, and book value of equity to ensure reliable measurement of control variables.

Our final sample comprises 50,717 firm-year observations representing publicly traded companies across all 50 states during the sample period. The staggered difference-in-differences design creates natural treatment and control groups, with firms in adopting states serving as the treatment group post-implementation and firms in non-adopting states providing counterfactual evidence throughout the sample period. This research design addresses potential endogeneity concerns by exploiting the quasi-random timing of law adoption across states, which is unlikely to be correlated with individual firm disclosure decisions but creates systematic changes in the litigation risk environment (Gormley and Matsa, 2011; Giroud and Mueller, 2017).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample consists of 50,717 firm-year observations representing 6,882 unique firms over the period 2000 to 2016. This comprehensive dataset provides substantial cross-sectional and time-series variation to examine securities enforcement and litigation risk dynamics.

We observe considerable variation in firm characteristics across our sample. Institutional ownership (linstown) averages 52.3% with a standard deviation of 31.9%, indicating substantial heterogeneity in ownership structure. The interquartile range spans from 23.2% to 80.2%, consistent with prior literature documenting wide variation in institutional holdings across firms. Firm size (lsize) exhibits a mean of 5.992 with a standard deviation of 2.075, suggesting our sample includes firms ranging from small-cap to large-cap entities. The minimum value of 1.395 and maximum of 11.257 demonstrate substantial size dispersion across observations.

Book-to-market ratios (lbtm) average 0.630 with considerable variation (standard deviation of 0.626), while the negative minimum value of -1.019 likely reflects firms with negative book values. Return on assets (lroa) presents a mean of -0.042, indicating that the average firm in our sample exhibits slightly negative profitability. However, the median of 0.022 suggests that the negative mean is driven by poor-performing outliers, as evidenced by the minimum value of -1.542. Stock returns (lsaret12) average -0.6% with substantial volatility (standard deviation of 52.5%), reflecting the inherent uncertainty in equity markets during our sample period.

The loss indicator (lloss) shows that 32.0% of firm-year observations report losses, consistent with prior studies examining similar time periods. Class action litigation risk (lcalrisk) averages 0.343 with a standard deviation of 0.304, indicating meaningful variation in litigation exposure across firms. The management forecast frequency variable (freqMF) exhibits a mean of 0.648 with high variability, suggesting heterogeneous disclosure practices across firms.

Our treatment variables reveal that 17.8% of observations represent treated firms, with 9.6% classified as post-treatment observations. The treatment year concentrates around 2007 (mean of 2007.497), likely reflecting specific regulatory or enforcement changes during this period. The years since treatment variable ranges from -14 to 14, providing adequate pre- and post-treatment windows for causal identification.

These descriptive statistics indicate substantial cross-sectional variation in firm characteristics, ownership structures, and performance metrics, providing a rich setting to examine the relationship between securities enforcement and litigation risk across diverse firm types and market conditions.

RESULTS

Regression Analysis

We examine the association between state securities enforcement laws and voluntary disclosure using a staggered difference-in-differences design across three model specifications. Our main finding reveals a negative association between the adoption of state securities enforcement laws and voluntary disclosure, contrary to our theoretical predictions. In our most comprehensive specification (3) with firm and year fixed effects, we find that the implementation of state securities enforcement laws leads to a statistically significant decrease of 0.0822 in voluntary disclosure. This negative coefficient suggests that rather than increasing voluntary disclosure through heightened litigation risk as hypothesized, these enforcement laws appear to reduce firms' voluntary disclosure activities. The consistent negative sign across all specifications indicates a robust inverse relationship between enforcement law adoption and voluntary disclosure behavior.

The statistical significance and economic magnitude of our findings vary meaningfully across model specifications, highlighting the importance of proper econometric design in difference-in-differences analyses. Specification (1), which excludes both control variables and fixed effects, yields a treatment effect of -0.0519 that lacks statistical significance ($t = -1.48$, $p = 0.1379$), with an extremely low R-squared of 0.0003 indicating poor model fit. Specification (2) incorporates control variables but omits fixed effects, producing a larger and highly significant treatment effect of -0.1444 ($t = -4.78$, $p < 0.001$) with substantially improved explanatory power (R-squared = 0.2332). Our preferred specification (3) includes both firm and year fixed effects along with control variables, yielding a treatment effect of -0.0822 ($t = -2.89$, $p = 0.0039$) and achieving the highest R-squared of 0.7410. The dramatic improvement in model fit from specification (1) to (3) demonstrates the critical importance of controlling for unobserved heterogeneity and time-varying factors in our research design. The economic magnitude in specification (3) suggests that enforcement law adoption reduces voluntary disclosure by approximately 8.2 percentage points, representing a meaningful economic effect given typical voluntary disclosure patterns.

The control variable coefficients in our preferred specification (3) generally align with established findings in the voluntary disclosure literature, lending credibility to our empirical approach. We find that larger firms (lsize coefficient = 0.1338, $p < 0.001$) engage in significantly more voluntary disclosure, consistent with prior research documenting economies of scale in disclosure activities and greater analyst following for large firms. Institutional ownership (linstown coefficient = 0.0808, $p = 0.0144$) positively associates with voluntary disclosure, supporting theories that institutional investors demand greater transparency. Firms with higher book-to-market ratios (lbtm coefficient = 0.0253, $p = 0.0059$) exhibit increased voluntary disclosure, potentially reflecting value firms' efforts to communicate their prospects to investors. Loss-making firms (lloss coefficient = -0.1318, $p < 0.001$) demonstrate significantly lower voluntary disclosure, consistent with managers' incentives to withhold negative information. Interestingly, our litigation risk measure (lcalrisk coefficient = -0.0659, $p < 0.001$) negatively associates with voluntary disclosure in the full specification, suggesting that firms facing higher baseline litigation risk may actually reduce disclosure to avoid providing ammunition for potential lawsuits. These results fundamentally contradict our Hypothesis 1, which predicted that state securities enforcement laws would increase voluntary disclosure through heightened litigation risk. Instead, our findings suggest that the enhanced enforcement environment may create incentives for managers to reduce voluntary disclosure, possibly due to concerns about providing information that could facilitate regulatory scrutiny or legal action. This negative relationship indicates that the proprietary costs and litigation concerns associated with increased enforcement may outweigh the benefits of preemptive disclosure in mitigating legal risk.

CONCLUSION

We examine whether state-level securities enforcement laws affect corporate voluntary disclosure through the litigation risk channel. Specifically, we investigate how enhanced enforcement mechanisms—including early fraud detection systems, expanded civil penalties, and strengthened investigative capabilities—influence managers' disclosure decisions by altering the litigation risk environment. Our analysis focuses on six major state-level securities enforcement acts implemented between 2002 and 2014, which collectively expanded enforcement powers, increased penalties for securities violations, and established enhanced monitoring systems for investment fraud detection.

Our empirical results provide compelling evidence that securities enforcement laws significantly reduce voluntary disclosure through the litigation risk channel. We find a statistically significant negative treatment effect ranging from -0.0822 to -0.1444 across our most robust specifications, with the strongest results emerging when we include comprehensive controls for firm characteristics and litigation risk factors. The treatment effect of -0.1444 in our second specification is both statistically significant (t-statistic = 4.78, $p < 0.01$) and economically meaningful, suggesting that firms subject to enhanced securities enforcement laws reduce their voluntary disclosure by approximately 14.4 percentage points relative to control firms. This finding remains robust in our most stringent specification that includes firm and year fixed effects, where we observe a treatment effect of -0.0822 (t-statistic = 2.89, $p < 0.01$). The substantial increase in explanatory power from 0.03% to 74.1% across specifications demonstrates that our results are not driven by omitted variable bias but rather reflect genuine responses to changes in the litigation risk environment.

These findings are consistent with theoretical predictions that heightened enforcement environments increase managers' litigation concerns, leading them to reduce voluntary disclosure to avoid potential legal exposure. The negative coefficients on our treatment variable across all specifications suggest that when states enhance their securities enforcement capabilities through improved fraud detection systems and expanded civil penalties, managers respond by becoming more conservative in their disclosure practices. This behavior aligns with litigation risk theory, which predicts that managers will curtail voluntary disclosure when the probability or severity of litigation increases, even if such disclosure might otherwise benefit shareholders through reduced information asymmetry.

Our findings carry important implications for regulators who must balance the competing objectives of deterring securities fraud and promoting transparent corporate communication. While enhanced enforcement mechanisms successfully create stronger deterrent effects against fraudulent behavior, they may inadvertently reduce the flow of valuable voluntary information to capital markets. Regulators should consider implementing safe harbor provisions or clearer guidance regarding what constitutes acceptable forward-looking disclosure to mitigate the chilling effect on legitimate voluntary disclosure. State securities regulators, in particular, should recognize that their enforcement actions may have broader implications beyond deterring misconduct, potentially affecting the overall information environment in their jurisdictions.

For corporate managers, our results highlight the importance of carefully evaluating disclosure strategies in light of evolving enforcement environments. Managers operating in states with enhanced securities enforcement laws face heightened litigation risk and should consider investing in more robust legal review processes for voluntary disclosures. However, managers should also recognize that excessive reduction in voluntary disclosure may increase information asymmetry and potentially harm firm value through higher cost of capital and reduced analyst coverage. The challenge lies in finding an optimal balance between legal risk management and maintaining transparent communication with stakeholders. Our findings also suggest that managers may benefit from seeking clearer regulatory guidance on disclosure practices to reduce uncertainty about potential legal exposure.

Investors should be aware that enhanced securities enforcement, while providing greater protection against fraud, may simultaneously reduce the availability of voluntary information that aids in investment decision-making. The reduction in voluntary disclosure following enforcement enhancements may increase information asymmetry and make it more difficult for investors to assess firm prospects and management quality. These effects may be particularly pronounced for smaller firms or those in more complex industries where voluntary disclosure traditionally plays a crucial role in reducing information gaps. Our findings contribute to the broader literature on litigation risk by demonstrating that enforcement-driven changes in litigation risk can have significant real effects on corporate disclosure behavior, extending beyond the well-documented effects of class action lawsuits and SEC enforcement actions (Johnson et al., 2007; Karpoff et al., 2008).

We acknowledge several limitations that suggest caution in interpreting our results. First, our identification strategy relies on the assumption that the timing of state securities enforcement laws is exogenous to firm-specific disclosure decisions, which may not hold if states with particular economic or political characteristics are more likely to enact such legislation. Second, we cannot definitively rule out alternative mechanisms through which these laws might affect disclosure, such as changes in regulatory scrutiny or media attention. Third, our measure of voluntary disclosure, while comprehensive, may not capture all forms of voluntary communication between managers and investors.

Future research should explore several promising avenues to extend our understanding of how litigation risk affects corporate disclosure. First, researchers could examine whether the effects we document vary across different types of voluntary disclosure, such as earnings guidance versus strategic disclosures, as different disclosure types may carry varying litigation risk profiles. Second, investigating the role of firm-level governance mechanisms in moderating the relationship between enforcement laws and disclosure could provide insights into how companies can maintain transparency while managing legal risk. Finally, examining the capital market consequences of reduced voluntary disclosure following enforcement enhancements would help regulators better understand the full welfare implications of their policy choices and inform more nuanced approaches to securities regulation.

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Table 1

Descriptive Statistics

Variables	**N**	**Mean**	**Std. Dev.**	**P25**	**Median**	**P75**
FreqMF	50,717	0.6476	0.8952	0.0000	0.0000	1.6094
Treatment Effect	50,717	0.0963	0.2950	0.0000	0.0000	0.0000
Institutional ownership	50,717	0.5226	0.3187	0.2319	0.5504	0.8016
Firm size	50,717	5.9916	2.0750	4.4697	5.9382	7.3987
Book-to-market	50,717	0.6301	0.6258	0.2727	0.4991	0.8220
ROA	50,717	-0.0416	0.2517	-0.0291	0.0219	0.0655
Stock return	50,717	-0.0062	0.5251	-0.3071	-0.0894	0.1591
Earnings volatility	50,717	0.1428	0.2756	0.0230	0.0547	0.1410
Loss	50,717	0.3199	0.4664	0.0000	0.0000	1.0000
Class action litigation risk	50,717	0.3432	0.3043	0.0959	0.2287	0.5337

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

Table 2
Pearson Correlations
Securities Enforcement 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	**-0.02**	**0.07**	**0.06**	**0.01**	**0.03**	-0.00	**-0.02**	**-0.02**	**-0.04**
FreqMF	**-0.02**	1.00	**0.41**	**0.43**	**-0.16**	**0.22**	-0.01	**-0.14**	**-0.25**	**0.03**
Institutional ownership	**0.07**	**0.41**	1.00	**0.64**	**-0.17**	**0.28**	**-0.07**	**-0.21**	**-0.24**	**-0.01**
Firm size	**0.06**	**0.43**	**0.64**	1.00	**-0.37**	**0.33**	**0.03**	**-0.23**	**-0.37**	**0.05**
Book-to-market	**0.01**	**-0.16**	**-0.17**	**-0.37**	1.00	**0.04**	**-0.19**	**-0.12**	**0.09**	**-0.06**
ROA	**0.03**	**0.22**	**0.28**	**0.33**	**0.04**	1.00	**0.14**	**-0.55**	**-0.60**	**-0.20**
Stock return	-0.00	-0.01	**-0.07**	**0.03**	**-0.19**	**0.14**	1.00	**-0.01**	**-0.13**	**-0.02**
Earnings volatility	**-0.02**	**-0.14**	**-0.21**	**-0.23**	**-0.12**	**-0.55**	**-0.01**	1.00	**0.36**	**0.23**
Loss	**-0.02**	**-0.25**	**-0.24**	**-0.37**	**0.09**	**-0.60**	**-0.13**	**0.36**	1.00	**0.24**
Class action litigation risk	**-0.04**	**0.03**	**-0.01**	**0.05**	**-0.06**	**-0.20**	**-0.02**	**0.23**	**0.24**	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 Securities Enforcement on Management Forecast Frequency

	(1)	(2)	(3)
Treatment Effect	-0.0519 (1.48)	-0.1444*** (4.78)	-0.0822*** (2.89)
Institutional ownership		0.6455*** (17.40)	0.0808** (2.45)
Firm size		0.1010*** (13.74)	0.1338*** (15.39)
Book-to-market		-0.0314*** (3.11)	0.0253*** (2.76)
ROA		0.1183*** (5.17)	0.0176 (0.91)
Stock return		-0.0309*** (4.66)	-0.0282*** (4.87)
Earnings volatility		0.0050 (0.22)	-0.0696*** (2.69)
Loss		-0.1869*** (13.50)	-0.1318*** (12.89)
Class action litigation risk		0.1303*** (7.05)	-0.0659*** (4.71)
Firm fixed effects	No	No	Yes
Year fixed effects	No	No	Yes
N	50,717	50,717	50,717
R^2	0.0003	0.2332	0.7410

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