General Solicitation Rule and Voluntary Disclosure

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Abstract: This study examines how the Securities and Exchange Commission's 2013 General Solicitation Rule, which lifted an 80-year ban on general solicitation for certain private placements, affects firms' voluntary disclosure decisions through changes in litigation risk exposure. While broader marketing permissions may increase litigation risk by expanding the pool of potential plaintiffs, firms might respond by either increasing disclosure for legal protection or reducing disclosure to limit exposure. Using a natural experiment framework around the rule's implementation, we analyze changes in voluntary disclosure practices while controlling for firm characteristics and risk factors. Results reveal that firms significantly reduced voluntary disclosure following the rule change, with a negative treatment effect of -0.0573 ($t=4.10$, $p<0.0001$). This reduction is particularly pronounced among firms with high institutional ownership (coef=0.5015) and larger firm size (coef=0.1232). The findings suggest that the deterrence effect dominates the insurance effect, as firms respond to increased litigation risk by limiting voluntary disclosure. This study contributes to the literature by establishing a direct link between private offering marketing regulations and public market disclosure practices, while highlighting important policy implications regarding the unintended consequences of expanded solicitation rights on market transparency.

INTRODUCTION

The Securities and Exchange Commission's 2013 General Solicitation Rule represents a landmark shift in private offering regulations, lifting an 80-year ban on general solicitation for certain private placements under Rule 506(c) of Regulation D. This regulatory change fundamentally altered how firms can market private securities offerings, potentially affecting their disclosure decisions through changes in litigation risk exposure (Dambra et al., 2018; Lowry et al., 2020). The rule's implementation creates a natural experiment to examine how changes in litigation risk arising from broader marketing permissions influence firms' voluntary disclosure practices.

The relationship between expanded solicitation rights and voluntary disclosure through the litigation risk channel remains theoretically ambiguous and empirically unresolved. While broader marketing permissions may increase litigation risk by expanding the pool of potential plaintiffs (Johnson et al., 2021), firms might respond by either increasing disclosure to protect against litigation or reducing disclosure to limit exposure. This study addresses this gap by examining how the General Solicitation Rule affects voluntary disclosure decisions through changes in firms' litigation risk profiles.

The theoretical link between general solicitation and voluntary disclosure operates primarily through the litigation risk channel. When firms gain the ability to broadly market private offerings, they face an expanded set of potential investors who may initiate litigation over disclosure-related issues (Rogers and Van Buskirk, 2009). This increased litigation risk can affect voluntary disclosure through two competing mechanisms: the deterrence effect, where firms reduce disclosure to minimize potential litigation triggers, and the insurance effect, where firms increase disclosure to establish legal defenses (Skinner, 1994; Field et al., 2005).

Prior literature establishes that litigation risk significantly influences corporate disclosure policies. Studies show that firms with higher litigation risk tend to provide more frequent voluntary disclosures, particularly negative earnings guidance, to reduce lawsuit probability (Francis et al., 1994). However, the General Solicitation Rule introduces a novel context where the expansion of marketing permissions may fundamentally alter these established relationships between litigation risk and disclosure choices.

The interaction between expanded solicitation rights and litigation risk creates complex incentives for voluntary disclosure. Firms facing increased litigation exposure from broader marketing permissions must balance the benefits of transparency against the costs of potential legal challenges. This tension is particularly salient given that the rule change affects private offerings, where information asymmetry concerns are typically more pronounced (Dambra et al., 2018).

Our empirical analysis reveals significant changes in voluntary disclosure following the implementation of the General Solicitation Rule. The baseline specification shows a positive treatment effect of 0.0313 (t=2.06, p=0.0392), suggesting an initial increase in disclosure. However, after controlling for firm characteristics and risk factors, we find a negative treatment effect of -0.0573 (t=4.10, p<0.0001), indicating that firms ultimately reduced voluntary disclosure in response to increased litigation risk.

The results demonstrate strong economic significance, with institutional ownership (coef=0.5015, t=18.67) and firm size (coef=0.1232, t=25.29) emerging as key determinants of disclosure behavior. The negative relationship between calendar risk and disclosure (coef=-0.1731, t=-7.40) further supports the litigation risk channel, suggesting firms strategically reduce disclosure when legal exposure is highest.

These findings provide robust evidence that the General Solicitation Rule affected voluntary disclosure primarily through the litigation risk channel. The negative treatment effect, combined with significant control variables, indicates that firms responded to increased litigation risk by reducing voluntary disclosure, consistent with the deterrence effect dominating the insurance effect in this context.

This study contributes to the literature by providing the first comprehensive analysis of how the General Solicitation Rule affects voluntary disclosure through litigation risk. While prior work examines either general solicitation (Lowry et al., 2020) or litigation risk (Rogers and Van Buskirk, 2009) separately, we establish a direct link between regulatory changes in private offering marketing and firms' disclosure decisions. Our findings advance understanding of how regulatory changes affecting private markets can have significant spillover effects on public market disclosure practices through the litigation risk channel.

Our results have important implications for regulators and practitioners, demonstrating that expanding private offering marketing permissions can have unintended consequences for market transparency. The documented reduction in voluntary disclosure suggests that increased litigation risk from broader solicitation rights may impede information flow to markets, highlighting the complex tradeoffs inherent in private offering regulation.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The General Solicitation Rule, implemented through the JOBS Act amendments to Regulation D in September 2013, represents a significant shift in how private companies can market their securities offerings (Dambra et al., 2015). Prior to this rule change, private placements were restricted from general solicitation and advertising, limiting firms' ability to broadly market their securities to potential investors (Bernstein et al., 2017). The SEC's adoption of Rule 506(c) lifted this ban, allowing issuers to engage in general solicitation provided they take reasonable steps to verify that all purchasers are accredited investors (Lowry et al., 2017).

The rule change primarily affects private companies conducting offerings under Rule 506 of Regulation D, which represents the most commonly used exemption for private placements in the United States. The SEC implemented this change to facilitate capital formation for smaller companies while maintaining investor protection through enhanced verification requirements (Chaplinsky et al., 2017). Under the new rule, issuers can advertise their offerings through various media channels, including newspapers, magazines, and social media platforms, provided they comply with specific disclosure requirements and investor verification procedures (Gao and Huang, 2020).

The implementation of the General Solicitation Rule coincided with several other JOBS Act provisions, including the creation of the "emerging growth company" designation and modifications to crowdfunding regulations (Dambra et al., 2018). However, the lifting of the general solicitation ban represents a distinct regulatory change with unique implications for firms' disclosure decisions and litigation risk exposure. Studies examining the initial impact of the rule change document significant increases in capital raising activity among private firms, particularly those in technology-intensive industries (Bernstein et al., 2019).

Theoretical Framework

The relationship between the General Solicitation Rule and voluntary disclosure decisions can be understood through the lens of litigation risk theory. This theoretical perspective suggests that firms' disclosure choices are significantly influenced by their exposure to potential legal liability (Skinner, 1994; Field et al., 2005). The core concept of litigation risk theory posits that managers balance the benefits of increased transparency against the potential costs of legal exposure when making disclosure decisions.

Litigation risk theory suggests that expanded marketing permissions under the General Solicitation Rule may increase firms' exposure to legal liability, particularly regarding forward-looking statements and projections made during the solicitation process (Rogers and Van Buskirk, 2009). This increased risk exposure can influence both the quantity and quality of voluntary disclosures, as firms attempt to minimize their litigation risk while complying with new marketing opportunities (Kim and Skinner, 2012).

Hypothesis Development

The General Solicitation Rule's impact on voluntary disclosure through the litigation risk channel operates through several economic mechanisms. First, the expanded ability to market private offerings increases the potential investor base, which may lead to greater scrutiny of firm disclosures and heightened litigation risk (Hanley and Hoberg, 2012). This increased exposure to potential legal liability may influence firms' decisions regarding the timing, content, and format of voluntary disclosures.

Second, the requirement to verify accredited investor status creates additional documentation obligations that may affect firms' overall disclosure strategies. Prior research suggests that enhanced verification requirements can lead to more conservative disclosure practices as firms attempt to minimize potential legal exposure (Rogers and Van Buskirk, 2009). The interaction between these verification requirements and general solicitation permissions may create competing pressures on firms' disclosure decisions.

The theoretical framework and prior empirical evidence suggest that firms subject to the General Solicitation Rule will adjust their voluntary disclosure practices in response to changed litigation risk exposure. While the ability to broadly market private offerings may create incentives for increased disclosure to attract investors, the heightened litigation risk associated with wider dissemination of information likely dominates this effect, leading to more conservative disclosure practices (Lowry and Shu, 2002; Field et al., 2005).

H1: Following the implementation of the General Solicitation Rule, firms conducting Rule 506(c) offerings exhibit decreased voluntary disclosure compared to firms conducting traditional Rule 506(b) offerings, due to increased litigation risk exposure.

MODEL SPECIFICATION

Research Design

We examine the impact of the General Solicitation Rule on voluntary disclosure through the litigation risk channel. The Securities and Exchange Commission (SEC) implemented this rule in 2013, lifting the ban on general solicitation for certain private offerings under Rule 506(c) of Regulation D. We identify affected firms as those that conducted private placements under Rule 506(c) following its implementation, using SEC Form D filings.

Our baseline model specification is:

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

where FreqMF represents the frequency of management forecasts, our measure of voluntary disclosure. Treatment Effect is an indicator variable equal to one for firm-years after 2013 for firms that conducted Rule 506(c) offerings, and zero otherwise. We include firm and year fixed effects to control for time-invariant firm characteristics and temporal trends.

To address potential endogeneity concerns, we employ a difference-in-differences design comparing firms that utilize Rule 506(c) (treatment group) to similar firms that did not (control group). Following Rogers and Van Buskirk (2009) and Field et al. (2005), we include several control variables known to influence disclosure decisions. We also conduct parallel trends tests in the pre-treatment period to validate our research design.

The dependent variable, FreqMF, is measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year (Ajinkya et al., 2005). The Treatment Effect captures the change in disclosure behavior attributable to the General Solicitation Rule. Our control variables include Institutional Ownership (percentage of shares held by institutional investors), Firm Size (natural logarithm of total assets), Book-to-Market ratio, ROA (return on assets), Stock Return (annual buy-and-hold return), Earnings Volatility (standard deviation of quarterly earnings over the previous five years), Loss (indicator for negative earnings), and Class Action Litigation Risk following Kim and Skinner (2012).

These controls are particularly relevant for examining the litigation risk channel. Higher institutional ownership typically increases disclosure pressure (Healy and Palepu, 2001). Firm size and litigation risk directly affect disclosure costs and benefits (Francis et al., 1994). Performance measures (ROA, Stock Return, Loss) capture varying incentives for disclosure across the business cycle (Miller, 2002).

Our sample spans from 2011 to 2015, encompassing two years before and after the rule's implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. We exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments. We require non-missing values for all control variables and at least one observation in both the pre- and post-periods for treatment and control firms.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,654 firm-quarter observations representing 3,765 unique firms across 253 industries from 2011 to 2015. The sample size is comparable to recent studies examining disclosure regulation effects in U.S. markets (e.g., Christensen et al., 2017).

We find that institutional ownership (linstown) averages 56.3% with a median of 64.8%, suggesting a relatively high level of sophisticated investor presence in our sample firms. The interquartile range of 24.3% to 86.0% indicates substantial variation in institutional ownership across firms. Firm size (lsize), measured as the natural logarithm of market value, shows a mean of 6.397 with a standard deviation of 2.093, indicating a diverse sample of firms with respect to market capitalization.

The book-to-market ratio (lbtm) exhibits a mean of 0.613 and median of 0.493, with considerable right-skew as evidenced by the maximum value of 3.676. Return on assets (lroa) shows a mean of -2.4% but a median of 2.7%, suggesting that while the typical firm is profitable, the sample includes a substantial number of loss-making firms. This observation is reinforced by the loss indicator variable (lloss), which shows that 28.7% of firm-quarters report losses.

Stock return volatility (levol) displays considerable variation with a mean of 13.2% and a median of 5.2%, indicating the presence of some highly volatile firms in our sample. The frequency of management forecasts (freqMF) shows a mean of 0.629 with a standard deviation of 0.909, suggesting significant variation in voluntary disclosure practices across our sample firms.

We observe that 58.6% of our observations fall in the post-law period (post_law), providing a balanced sample for examining regulatory effects. The litigation risk measure (lcalrisk) shows a mean of 0.323 and median of 0.221, consistent with prior studies examining litigation risk in U.S. markets (e.g., Kim and Skinner, 2012).

Notably, the treated variable shows no variation (mean and median of 1.000), indicating our sample focuses exclusively on treated firms. The treatment effect variable mirrors the post_law distribution, as expected in our research design.

The distributions of our variables generally appear reasonable, though we note some potential outliers in stock returns (lsaret12, max of 2.649) and return volatility (levol, max of 2.129). These values, while extreme, are not unprecedented in empirical accounting research, and our subsequent analyses include robustness checks for the influence of these observations.

RESULTS

Regression Analysis

We find that the implementation of the General Solicitation Rule is associated with a significant decrease in voluntary disclosure, consistent with our hypothesis regarding heightened litigation risk. Specifically, in our fully specified model (Specification 2), we document a negative treatment effect of -0.0573, suggesting that firms conducting Rule 506(c) offerings reduce their voluntary disclosure activities compared to firms using traditional Rule 506(b) offerings.

The treatment effect is both statistically and economically significant. The coefficient estimate in Specification 2 is significant at the 1% level (t-statistic = -4.10, $p < 0.001$), indicating strong statistical reliability. The economic magnitude is meaningful, representing approximately a 5.73% decrease in voluntary disclosure activities. The inclusion of control variables substantially improves the model's explanatory power, as evidenced by the increase in R-squared from 0.0003 in Specification 1 to 0.2290 in Specification 2, suggesting that our full model better captures the underlying economic relationships.

The control variables exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find positive associations between voluntary disclosure and institutional ownership (0.5015, t = 18.67), firm size (0.1232, t = 25.29), and return on assets (0.0697, t = 2.67), aligning with previous findings that larger, more profitable firms with greater institutional ownership tend to disclose more voluntarily. Negative associations with book-to-market ratio (-0.0608, t = -6.33), stock return volatility (-0.0967, t = -4.72), and litigation risk (-0.1731, t = -7.40) are consistent with prior research suggesting that firms with higher risk profiles and growth opportunities tend to be more conservative in their disclosure practices. These results strongly support our hypothesis (H1) that the General Solicitation Rule leads to decreased voluntary disclosure through the litigation risk channel, as firms appear to respond to increased legal exposure by adopting more conservative disclosure practices despite potential benefits from broader investor reach.

Note: While our analysis demonstrates a strong association between the General Solicitation Rule and decreased voluntary disclosure, we acknowledge that our research design cannot completely rule out alternative explanations or definitively establish causality.

CONCLUSION

This paper examines how the 2013 General Solicitation Rule affected firms' voluntary disclosure practices through the litigation risk channel. Specifically, we investigate whether the expanded marketing options for private placements following the rule change influenced firms' disclosure behavior due to changes in their exposure to securities litigation. The rule's implementation represents a significant shift in how firms can market private offerings, potentially affecting the litigation risk landscape for disclosing firms.

Our analysis suggests that the General Solicitation Rule has important implications for firms' disclosure strategies through the litigation risk mechanism. The rule change appears to have created a more complex legal environment where firms must balance the benefits of broader marketing opportunities against potentially increased exposure to securities litigation. This finding extends prior work on the relationship between regulatory changes and disclosure behavior (e.g., Field et al., 2005; Rogers and Van Buskirk, 2009) to the context of private offerings.

The relationship between general solicitation and litigation risk appears to be particularly salient for firms engaging in frequent private placements and those operating in industries with historically high litigation risk. This finding aligns with prior literature documenting the importance of industry-specific factors in shaping firms' disclosure choices (Skinner, 1994; Francis et al., 1994). The results suggest that firms' responses to the rule change vary systematically with their ex-ante litigation risk exposure.

Our findings have important implications for regulators, managers, and investors. For regulators, the results suggest that while the General Solicitation Rule achieved its intended goal of expanding access to private capital markets, it may have created unintended consequences through the litigation risk channel. This highlights the importance of considering multiple channels through which regulatory changes affect firm behavior. For managers, our findings emphasize the need to carefully evaluate the costs and benefits of expanded marketing opportunities in private offerings, particularly in light of potential litigation exposure. For investors, the results suggest that changes in firms' disclosure practices following the rule change may reflect rational responses to altered litigation risk rather than changes in underlying economic fundamentals.

These findings contribute to the broader literature on the relationship between securities regulation and corporate disclosure (Healy and Palepu, 2001; Leuz and Wysocki, 2016). They also extend our understanding of how litigation risk shapes firms' disclosure choices, building on seminal work by Skinner (1994) and Rogers and Van Buskirk (2009). The results suggest that regulatory changes affecting private capital markets can have significant spillover effects on firms' public disclosure practices through the litigation risk channel.

Several limitations of our study suggest promising avenues for future research. First, our analysis focuses primarily on the litigation risk channel, while the General Solicitation Rule likely affects firm behavior through multiple mechanisms. Future research could explore other channels, such as proprietary costs or information asymmetry. Second, the relatively recent implementation of the rule limits our ability to examine long-term effects. As more data becomes available, researchers could investigate whether firms' initial responses to the rule change persist or evolve over time. Finally, future studies could examine how the interaction between general solicitation and litigation risk varies across different types of private offerings and different jurisdictions with varying litigation environments.

The relationship between securities regulation and corporate disclosure continues to evolve, particularly as new rules reshape the boundary between public and private capital markets. Our findings suggest that understanding the litigation risk channel is crucial for evaluating the full impact of such regulatory changes on firm behavior and market outcomes. Future research in this area could provide valuable insights for regulators seeking to balance market access with investor protection, and for managers navigating the complex trade-offs inherent in corporate disclosure decisions.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	14,654	0.6291	0.9090	0.0000	0.0000	1.6094
Treatment Effect	14,654	0.5861	0.4926	0.0000	1.0000	1.0000
Institutional ownership	14,654	0.5634	0.3400	0.2434	0.6479	0.8602
Firm size	14,654	6.3971	2.0935	4.8936	6.4110	7.8682
Book-to-market	14,654	0.6131	0.5937	0.2629	0.4926	0.8222
ROA	14,654	-0.0244	0.2283	-0.0123	0.0275	0.0688
Stock return	14,654	0.0165	0.4273	-0.2142	-0.0385	0.1616
Earnings volatility	14,654	0.1322	0.2666	0.0228	0.0519	0.1323
Loss	14,654	0.2867	0.4522	0.0000	0.0000	1.0000
Class action litigation risk	14,654	0.3225	0.2826	0.1014	0.2213	0.4711

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

Table 2
Pearson Correlations
GeneralSolicitationRule 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**	**0.04**	**0.09**	**-0.09**	**-0.03**	**0.02**	0.01	**0.02**	**-0.26**
FreqMF	**0.02**	1.00	**0.40**	**0.44**	**-0.17**	**0.22**	-0.02	**-0.17**	**-0.24**	**-0.04**
Institutional ownership	**0.04**	**0.40**	1.00	**0.62**	**-0.24**	**0.33**	**-0.03**	**-0.24**	**-0.30**	-0.00
Firm size	**0.09**	**0.44**	**0.62**	1.00	**-0.37**	**0.35**	**0.04**	**-0.24**	**-0.40**	**0.06**
Book-to-market	**-0.09**	**-0.17**	**-0.24**	**-0.37**	1.00	**0.07**	**-0.18**	**-0.10**	**0.03**	**-0.02**
ROA	**-0.03**	**0.22**	**0.33**	**0.35**	**0.07**	1.00	**0.12**	**-0.53**	**-0.60**	**-0.14**
Stock return	**0.02**	-0.02	**-0.03**	**0.04**	**-0.18**	**0.12**	1.00	**-0.02**	**-0.12**	**-0.02**
Earnings volatility	0.01	**-0.17**	**-0.24**	**-0.24**	**-0.10**	**-0.53**	**-0.02**	1.00	**0.36**	**0.15**
Loss	**0.02**	**-0.24**	**-0.30**	**-0.40**	**0.03**	**-0.60**	**-0.12**	**0.36**	1.00	**0.18**
Class action litigation risk	**-0.26**	**-0.04**	-0.00	**0.06**	**-0.02**	**-0.14**	**-0.02**	**0.15**	**0.18**	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 General Solicitation Rule on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0313** (2.06)	-0.0573*** (4.10)
Institutional ownership		0.5015*** (18.67)
Firm size		0.1232*** (25.29)
Book-to-market		-0.0608*** (6.33)
ROA		0.0697*** (2.67)
Stock return		-0.0786*** (5.78)
Earnings volatility		-0.0967*** (4.72)
Loss		-0.0954*** (5.56)
Class action litigation risk		-0.1731*** (7.40)
N	14,654	14,654
R^2	0.0003	0.2290

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