

monitoring of regulators and allows private parties access to information previously only privy to regulators. The alignment in incentives and information likely results in greater overlap in enforcement actions as the two mechanisms converge on higher-quality cases, potentially improving enforcement outcomes.¹

To test our conjecture, we focus on the interaction between the SEC, a public enforcer, and private shareholder litigants, a private enforcement mechanism, following an SEC policy change that initiated the public disclosure of SEC comment-letter correspondence. Specifically, in June 2004, the SEC announced a shift in policy: starting with corporate reports filed after August 1, 2004, the agency would publicly disclose its comment letters and corporate filers' responses. Before this policy change, comment letters were only accessible to parties who filed a Freedom of Information Act (FOIA) request. The stated objective of the policy change was to alleviate both the delay and the selective access to SEC comment letters. In making the comment letters public, the SEC increased the transparency of its oversight activities.² We examine whether this increased transparency facilitates the alignment of the public and private enforcers' incentives and information sets, resulting in a greater overlap of enforcement actions. Our evidence suggests that public enforcement (via SEC comment letters) and private enforcement (via private securities litigation) coincide to a greater extent after the SEC comment letters are released publicly. Additionally, there appears to be an increased alignment in timing: the (absolute) filing lag between private and public enforcement activities declines significantly following the SEC's disclosure policy change.

Having demonstrated greater alignment in enforcement following the public disclosure of SEC comment letters, we turn to the specific factors contributing to the alignment. First, we consider the SEC's incentive alignment: Did the SEC increase enforcement efforts after its enforcement activities became more observable and easily monitored? We find that the SEC steps up its oversight activities during the post-public disclosure period. Specifically, the SEC is more likely to issue comment letters to firms with questionable accounting practices (i.e., firms that eventually must restate their financials).

In addition to increased enforcement efforts, the SEC is also less susceptible to political influence in the post-

disclosure period. Whereas the SEC was less likely to enforce against politically connected firms in the pre-disclosure period when the SEC's oversight activities were not readily observable, we find a positive association in the post-disclosure period, consistent with Heese et al. (2017). The conflicting evidence in the two disclosure regimes provides a reconciliation of contradictory findings in Correia (2014) and Heese et al. (2017): While the SEC can be captured when its actions are opaque to the public, such incentives are mitigated, even reversed, when the SEC's actions become visible to the public. In sum, the SEC's increased tendency to issue comment letters to restating firms and to politically connected firms suggests that regulatory transparency reduces political capture and enhances regulators' incentives to detect financial reporting problems.

Next, we turn to the role of information alignment. We conjecture that public disclosure of SEC comment letters enhances private parties' information access by revealing information previously only privy to the SEC.³ The narrowed information gap between private litigants and the SEC likely results in a greater overlap of enforcement targets. We conduct two sets of tests of the information channel. First, we conduct cross-sectional tests that examine whether the increased overlap is greatest for firms with more information asymmetry (i.e., smaller, younger firms with less institutional ownership and fewer analysts following). Our findings are broadly consistent with these predictions.

In our second set of tests of the information channel, we examine whether the availability of information from SEC's filing reviews improves private litigants' ability to identify "quality" lawsuits. With access to SEC comment letter correspondence, plaintiffs' attorneys can more easily target firms with questionable financial reporting practices, thereby reducing nuisance lawsuits. We hypothesize that the increased merit of securities litigation translates to a lower likelihood of case dismissal and larger settlement amounts. In this analysis, we focus on the effect of enhanced information access on the merit of cases pursued by securities lawyers. To isolate the impact of the litigants' information access and avoid the confounding effects of the changing SEC's incentives across the two disclosure regimes, we focus exclusively on the post-disclosure period. To capture differential information access, we exploit the relative timing of a lawsuit filing date and the related comment letter dissemination date. If a lawsuit is filed after (before) the relevant comment letters are disseminated, then the plaintiffs have (do not have) access to relevant correspondence between the SEC and the registrant.

¹ Greater overlap demonstrates the complementarity of public and private enforcement. Private mechanisms pick up where the public enforcement stops (due to resource constraints or incentive problems). Aided by greater regulatory transparency, private enforcers can better target corporate wrongdoing and impose additional costs on the bad actors. Ultimately, the alignment of the two mechanisms leads to more efficient enforcement if the engagement of both holds more corporate wrongdoers accountable while reducing deadweight loss associated with nuisance cases.

² SEC oversight activities range from the Division of Corporate Finance (DCF)'s review and comment process to the Division of Enforcement's (DOE's) issuance of Accounting and Auditing Enforcement Releases (AAERs). The latter involves the most egregious fraud cases and captures only a small fraction of the SEC's overall enforcement. Most accounting and disclosure deficiencies that come to the SEC's attention are resolved through the SEC's review and comment process (Bayless, 2000; Heese et al., 2017).

³ Plaintiff lawyers could, in theory, request comment letter correspondence via FOIA before 2004. However, access to such correspondence was severely limited. First, plaintiff attorneys had no reliable means of identifying which firms received comment letters, so they could not file relevant FOIA requests. For the SEC to process a FOIA request, the request had to name a specific company for specified dates (i.e., one could not ask for, say, all comment letters issued in 2002 to Fortune 500 firms). Duro et al. (2019) highlight that before 2004, only 56% of the comment letter FOIA requests were "accepted" by the SEC, and the SEC took an average of 697 days to respond.