Political Values and SEC Enforcement Actions

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Abstract

The Securities and Exchange Commission (SEC) plays a central role in investigating potential violations of securities laws and initiating enforcement actions. In this study, we examine the association between political culture and the penalties imposed at the end of SEC enforcement actions. Our analysis is based on two key ideas. First, political culture of a firm indicates its ethical boundaries and explains the propensity of misconduct across different domains, such as securities laws. Second, political connections signal a firm's willingness to challenge SEC's enforcement decisions. We find that the individual defendants associated with Republican firms are less likely to receive a bar or suspension penalty. This finding supports the notion that Republican managers are less likely to commit securities fraud since the Republican ideology stresses market discipline. Moreover, in line with the prior research, our results show that political connections and firm size, as a proxy for bargaining power, also reduce penalties imposed in SEC enforcement actions.

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1. Introduction

The role of the Securities and Exchange Commission (SEC) in enforcing securities laws is widely recognized by the media and extensively studied in the finance literature. Several studies explore the types of accounting problems and securities violations that induce enforcement actions (Feroz, Park, & Pastena, 2008), the effect of SEC's constraints and preferences on firms' compliance and their propensity for violations (Kedia & Rajgopal, 2011; Lohse, Pascalau, & Thomann, 2014), the consequences of SEC enforcement actions for firms targeted by the SEC and their managers (Feroz, Park, & Pastena, 2008; Karpoff, Lee, & Martin, 2008), and how firms are able to influence the enforcement decisions (Gadinis, 2012; Correia, 2014). In each enforcement action, the SEC faces three important decisions: the choice between an administrative proceeding and litigation, the sanctions brought against individual employees associated with the target firm, and the type and severity of penalties against the firm and individual defendants. These choices could be affected by the SEC's resource constraints as well as the firms' resources to fight the Commission's decisions, the complexity of violations and the size of the harm to investors, and whether violations involve extreme recklessness or intent.

In this paper, we focus on the relationship between political culture and SEC enforcement actions. The support for this relationship is provided in a study by Hutton, Jiang, & Kumar (2015), who show that political culture could indicate a firm's propensity for corporate misconduct. They argue that PAC contributions to political candidates associated with the Democratic or Republican Parties are an indicator of political environment within firms. Moreover, political culture could define the ethical boundaries of a firm and the tendency to misconduct across different domains. Hutton, Jiang, & Kumar state that since the Republican ideology promotes an economic system based on market discipline, Republican firms are less likely to commit securities fraud compared to Democratic firms. In this study, we hypothesize that in SEC enforcement cases which involve firms with a Republican culture, the intent for violation is less likely. Therefore, Republican firms

are expected to receive lower penalties. We find strong support for this hypothesis, especially in terms of sanctions against individual defendants in target firms.

The main contribution of this paper is to study the relationship between political culture and SEC enforcement actions. We build upon Hutton, Jiang, & Kumar (2014) and Hutton, Jiang, & Kumar (2015) and use political contributions as a signal for political culture. This paper also provides additional evidence on whether political connections, a signal for a firm's willingness to fight SEC enforcement decisions, and firm size, a proxy for a firm's legal resources, reduce the costs associated with SEC enforcement actions.

To assess the likely impact of these factors, we use a hand-collected sample of all SEC enforcement actions against the Standard & Poor's (S&P) 500 firms available through the SEC's Administrative Proceedings and Litigation Releases Archives from 1996 to 2014. We examine multiple decisions by the Commission in each enforcement action. In particular, we examine the choice between administrative and court proceeding, and the decisions regarding bar or suspension penalties against individual defendants, disgorgement,[1] `and civil and criminal fines. Our estimates indicate that a $10 increase in long-term average annual PAC contributions to Republican candidates reduces the odds of a bar or suspension penalty by 2.78%, while the same dollar increase in PAC contributions to Democratic candidates increase the odds by 4.88%. These effects are economically and statistically significant and robust to alternative specifications. Our results also show that larger firms are significantly less likely to be brought to court or receive a bar or suspension penalty against their executives. Finally, we find that total PAC contributions, our measure of political connections, reduces disgorgement.

The rest of this paper is organized as follows. Section 2 provides a review of the related literature and develops our main hypotheses. Section 3 explain the data and the main dependent

[1] Disgorgement is the restitution of ill-gotten gains to those affected by fraud or violations of securities laws (e.g., shareholders) and includes any accrued interest between the time of the violations and the enforcement date. Disgorgement could be imposed on firms or individual defendants.

and explanatory variables. Section 4 explains the empirical methodology and discusses the main results and robustness tests. Section 5 concludes the paper.

2. Literature Review and Hypotheses

Our study is related to the research that links finance to politics and corporate law. Firstly, this paper contributes to the literature that investigates the role of political culture and preferences in shaping corporate policy and a propensity for misconduct. Although the finance literature identifies several determinants of corporate misconduct,[2] few studies consider corporate culture as an indicator of white-collar crime. In a recent study, Hutton, Jiang, & Kumar (2015) examine how political ideology affects the likelihood that a U.S. firm will be subject to a particular type of litigation. They show that firms with a Democratic ideology are subject to securities fraud and intellectual property rights-related litigation more frequently than firms with a Republican ideology. They measure political ideology, or culture, using the political contributions by a firm's political action committee (PAC), its top managers and residents located in the firm's state of residence. They argue that political contributions could be regarded as a signal of political values and, consequently, the choice of political values is an indicator of corporate culture. Therefore, since the Republican Party ideology promotes market discipline and property rights, firms associated with the Republican Party are less likely to be in violation of securities or intellectual property laws.

Secondly, many studies explore the benefits of political connections with respect to scrutiny and enforcement actions by independent regulating agencies such as the SEC. This literature is divided into two sub-streams. One stream of the literature discusses the overall usefulness of private versus public enforcement actions. For example, La Porta, Lopez-de-Silanes, & Shleifer

[2] For example, Kedia & Rajgopal (2011) find that relative geographical proximity to SEC offices or to areas with high past SEC enforcement activity reduces firms' tendency to restate their financial statements.

(2006) investigate whether public enforcement benefits the financial market by examining the effects of securities law on stock market development. There are two opposing views on the subject. On the one hand, it is argued that securities markets should be left unregulated as publicly-traded firms have an incentive to disclose all available information to obtain higher prices and avoid reputational, legal and contractual penalties. On the other hand, it is argued that reputational and contractual penalties are insufficient to prevent firms from cheating since the payoffs from cheating are large and contract litigation is expensive. The proponents of the latter argument offer two alternative levels of government intervention: either the law should standardize the private contracting framework by specifying liability standards and mandating certain disclosures, or, the market should establish an independent public enforcer, such as the SEC, which supports trade and is able to intervene ex-ante to prevent a crisis or ex-post to respond to a crisis. The researchers find a mixed evidence in this respect. (La Porta, Lopez-de-Silanes, & Shleifer, 2006; Jackson and Roa, 2009).

The second sub-stream, which is more relevance to our study, specifically investigates the enforcement actions by the SEC. For example, Hochberg, Sapienza, & Vissing-Jørgensen (2009) provide evidence that unlike investors, corporate insiders and business groups lobbied politicians against strict implementation of the Sarbanes-Oxley Act of 2002. They further find that those corporate insiders belong to firms characterized by agency problems. Therefore, their actions are not likely to be motivated by concerns over compliance costs of the new regulations. Feroz, Park, & Pastena (2008) investigate the SEC's Accounting and Auditing Enforcement Releases (AAERs) and report that the Commission mainly prosecutes firms in the event of material breaches; that is, financial disclosure violations which affect the reported income by over 50%. They also report serious consequences for the target firm's managers and its auditors and find that investors strongly react to such information. Specifically, they observe a two-day abnormal return of -13% at the time of the disclosure of violations. Even in cases where the accounting error was announced earlier, there is still a strong negative reaction (an abnormal return of -6%) to the disclosure of the investigation.

In a study directly related to our paper, Gadinis (2012) looks at SEC enforcement actions against investment banks and brokerage houses and find that bigger firms fare better compared to smaller firms with respect to SEC enforcement actions. For instance, he finds that relative to small firms, SEC actions against big firms are more likely to only involve administrative actions, rather than court proceedings and lower sanctions. In related research, Karpoff, Lee, & Martin (2008) study the validity of the popular notion that managers mostly get away with financial misrepresentation to investors. They explore consequences of SEC and Department of Justice (DOJ) enforcement actions against financial misrepresentation for the managers of the target firms. Contrary to popular belief, the study finds that individual managers responsible for financial misconduct face a variety of significant disciplinary actions such as job termination, financial penalties, restrictions on future jobs, and jail sentences.

This study is also related to a growing literature on political connections and their costs and benefits with regard to a firm's financial decisions and performance. The positive firm-level outcomes, especially from the shareholders' perspective, are reported for both the developing and the developed world. Faccio (2006) argues that politically connected firms are more prevalent in countries with poor legal systems, whereas Goldman, Rocholl, & So (2009) and Cooper, Gulen, & Ovtchinnikov (2010) report the prevalence of politically connected firms in countries with well-functioning legal systems, such as the U.S. The importance of political connections is highlighted through direct (when either a firm's executive or large shareholder enters politics or when a politician joins the board of directors of a firm) as well as indirect (when a firm contributes to a political campaign or incurs significant lobbying expenditures) channels.

With respect to the benefits of political connections, the literature documents the effects of firm-level political connections on better business opportunities, lower tax rates, reduced regulatory requirements, preferential access to government funding, lower cost of equity, lower cost of private debt, higher stock return, higher firm value, more profitability, and higher likelihood of a bailout during a financial crisis (Boubakri, Guedhami, Mishra, & Saffar, 2012; Blau, Brough, & Thomas, 2013; Kim, Pantzalis, & Park, 2012; Houston, Lin, Lin, & Ma, 2014; Yu, Zhang, &

Zheng, 2015). For instance, Khawaja and Mian (2005) show that in emerging financial markets, such as Pakistan, with relatively high corruption and an underperforming legal system, lenders favour connected firms even though connected firms experience a higher default rate relative to unconnected firms. Their findings support the bank channel.

Next, several studies report a positive effect of political connections on stocks returns, firm value and firm performance (Cooper, Gulen, & Ovtchinnikov, 2010; Goldman, Rocholl, & So, 2009; Faccio, 2006; Faccio, Masulis, & McConnell, 2006; Chaney, Faccio, & Parsley, 2011; Ovtchinnikov & Pantaleoni, 2012). Cooper, Gulen, & Ovtchinnikov (2010) find that the extent of a firm's support to political candidates is positively correlated with future returns and the relationship is even stronger if the firm supports a local, House or Democratic candidate. Similarly, Goldman, Rocholl, & So (2009) report that the announcement of a politically connected member on the board of directors results in positive abnormal stock returns. They also find that during the 2000 election of the Republican president, firms connected to the Republican Party gained value at the cost of those connected to the Democratic Party. Ovtchinnikov & Pantaleoni (2012) assert that political contributions by individuals are targeted at politicians with jurisdiction over firms or industries in their Congressional district. They find that this targeted contribution improves the individuals' well-being by increasing the performance of the firms in the district.

Gropper, Jahera, & Park (2013) find that banks headquartered in a state with a local politician who serves as the chairman of the respective banking committee in Congress (either the House or Senate) tend to outperform banks headquartered in other states. This effect is more pronounced if the chair is more aligned with other politicians, for more experienced chairs and when the bank headquarters are clustered in the state. In addition literature confirms that politically connected firms in Thailand have high realized returns (Civilize, Wongchoti, & Young, 2015), firms located in states with higher alignment to the ruling party outperform those located in other states (Kim, Pantzalis, & Park, 2012)for firms, and politically connections of firms and managers in China reduce the contagion effect of scandals on non-state-owned peers.

Several studies have investigated the costs of political connections. For example, agency and governance issues arising from political affiliation of a firm's management could result in rent-extracting activities by politicians at the expense of other stakeholders (Boubakri, Guedhami, Mishra, & Saffar, 2012). Specifically, compared to non-connected firms, politically-connected firms are found to have lower earnings quality (Chaney, Faccio, & Parsley, 2011), less accurate analyst forecasts (Chen, Ding, & Kim, 2010), poor post-IPO stock returns for newly privatized firms (Fan, Wong, & Zhang, 2007), and lower profits, especially during election years and in politically contested areas (Bertrand, Kramarz, Schoar, & Thesmar, 2006).

Finally, a few researchers have investigated firms' motivation for making political donations. Kroszner & Stratmann (1998) explore campaign contribution patterns by proposing a theory that aims at explaining how interest-group competition operates and how it shapes the organization of Congress. They argue that in the absence of a formal contract, it is in the interest of the legislators to establish specialized committees to facilitate long-term relationship between PACs and the members of such committees. This would, subsequently, lead to an equilibrium with high political contributions and high legislative effort. According to the study, organized interest groups may influence legislators' activities in order to seek votes in the interest-group's favour or impose pressure on "independent" regulatory agencies through budgetary control, oversight hearings, and in the Senate, confirmation processes. Similarly, Shleifer & Vishny (1994) study the political influence on both public and private enterprises using a game theory approach that models the interaction between the public, politicians, and managers. Based on the assumption that the public is disorganized, they show that politicians end up catering to interest groups instead of focusing on the median voter. Zingales (2015) considers the role of political donations, especially by large banks, as insurance against the negative public sentiments under stress. When anti-finance sentiment surges after a financial crisis, the enforcement of financial contracts is difficult. Under these circumstances and due to the lack of public support, financiers need political support to operate. Therefore, some financiers pay heavily for lobbying to obtain that support.

2.1. PAC Contributions and Political Connections

As discussed above, the empirical findings mainly support the idea that political connections, either through explicit relationships between politicians and firms or through political expenditures by firms, are valuable. These expenditures, by way of lobbying expenses or PAC contributions, are traditionally viewed as long-term investments in politicians' election and career progress in exchange for possible future favours (Baron, 1989; Snyder Jr., 1992; Grossman & Helpman, 1994). In the case of SEC enforcement actions, the political favour could be increased pressure on the Commission if it decides to prosecute a connected firm. Since the SEC has a limited budget and faces resource constraints (the "constrained cop" hypothesis), it will be unwilling to pursue politically connected firms when faced with the possibility of added pressure (Kedia & Rajgopal, 2011). In line with this argument, Correia (2014) finds that politically connected firms are less likely to be the target of an enforcement action by the SEC. She uses political contributions by a firm's PAC and its executives together with lobbying expenses as a proxy for political connections. Additionally, Correia shows that, conditional on an enforcement action, connected firms are subject to lower penalties. We re-examine this hypothesis and formulate it as follows:

H1: If prosecuted by the SEC, politically connected firms receive lower penalties.

The long-term relationship between firms and politicians may not necessarily lead to a political favour. Alternatively, the pre-existence of a relationship could signal to the SEC the increased costs of prosecution against such firms. For example, Gordon & Hafer (2005) suggest that political contributions convey a firm's willingness to battle a government agency's actions against the firm and act as a deterrence to future complaints or prosecutions. Although theoretically different, the "signalling" argument is empirically equivalent to the "constrained cop" hypothesis. Therefore, our first hypothesis cannot distinguish between the two alternative explanations of the relationship between political connections and SEC enforcement actions.

2.2. Firm Size and Bargaining Power

Considering the SEC's budget constraint and lack of bureaucratic resources, it is expected that the Commission only pursues cases in which there is a high probability of winning.[3] This may prevent the SEC from pursuing high-profile cases concerning firms with means to battle the enforcement action. Consistent with this argument, Gadinis (2012) finds that large financial firms (i.e., brokers and dealers) are less likely to end up in litigation and, on average, less likely to receive any sanctions against their individual employees, compared to their smaller counterparts. Although Gadinis' study focuses exclusively on the financial industry, the same outcome could be expected in the SEC's actions against firms in other industries. Similarly, Feroz, Park, & Pastena (2008) examined accounting-related enforcement actions and found that when the SEC prosecutes a firm's auditor, higher penalties are more likely to be levied against smaller audit firms.[4] We examine this relationship empirically with the following hypothesis:

H2: If prosecuted by the SEC, larger firms receive lower penalties.

According to the Securities Act of 1934, the SEC has broad authority over all aspects of the securities industry and the power to require disclosure of material information and to enforce disciplinary actions against regulated entities and individuals associated with them. Proponents of the "public interest" view of regulation assert that the SEC induces publicly traded firms to disclose an optimal level of information to their investors and, subsequently, improves social welfare. By contrast, advocates of the "private interest" view perceive the regulatory process as a means to transfer wealth to small but concentrated interest groups (Stigler, 1971; Peltzman, 1976). This view of regulation could place the SEC's activities in contrast to its mandate, especially since the Commission's reach appear to have expanded significantly after the Sarbanes-Oxley (SOX) Act

[3] For example, Lohse, Pascalau, & Thomann (2014) find that the increase in the SEC's budget is translated into increased activity of the Commission and improved compliance by firms.

[4] Although the present study only considers S&P 500 firms, there is a significant variation in firm size between the firms in our sample (see Table 1, Panel D).

of 2002 (Romano, 2005; Smith, 2007; Mulherin, 2007). For example, Romano argues that the SOX mandates are at odds with the extant literature, which highlights the inefficacy of the proposed regulations; however, the legislators used the collapse of WorldCom and Enron as the justification for the implementation of corporate governance initiatives through SOX.

It is possible that the SEC favours cases against large firms that are politically connected. Although bringing actions against those firms could prove more difficult for the SEC, if successful, they could help advertise the Commission's activities. This is crucial in light of the expansion in the SEC's jurisdiction and recent increase in its budget (Mulherin, 2007; Lohse, Pascalau, & Thomann, 2014). Moreover, large political expenditures by big firms can implicate them if a violation occurs; and if the SEC proves that the management has acted "intentionally" or displayed "recklessness" in their violation, it can impose significant sanctions and civil penalties on the firm. In order to empirically test this conjecture, we can examine the joint effect of firm size and political connections on SEC administrative actions. In particular, we propose the following hypothesis:

> *H3:* If prosecuted by the SEC, firms which are larger and, at the same time, politically connected, receive higher penalties.

2.3. PAC Contributions and Political Values

Political contributions are commonly regarded as a "signal" for political connections. Additionally, contributions could indicate a firm's political orientation or that of its management. Firms (individuals) that contribute to the campaigns of Republican or Democratic candidates can be viewed as having a Republican or Democratic orientation, respectively. Hutton, Jiang, & Kumar (2015) examine the relationship between political culture and corporate litigation. They argue that the contributions of a firm's PAC, of its top managers and of local residents in the firm's headquarters state (a proxy for preferences of lower-level employees) to different political parties indicate the firm's political leaning or party identification. Moreover, party identification is stable over time and is associated with distinct ideologies and values (Goren, 2005). For example, the

Republican Party's ideology underlines the principles of equal opportunity, limited government and the protection of property rights.

Hutton, Jiang, & Kumar (2015) find that firms with a Republican culture are less often the subject of securities fraud and intellectual property rights litigation since they are less likely to violate securities or intellectual property laws. Similarly, Hutton, Jiang, & Kumar (2014) find that Republican managers – that is, individual managers who exclusively contribute to the Republican Party in most election cycles – maintain lower leverage and undertake less risky investments. They argue that since the Republican Party is associated with more conservative personal behaviour, Republican managers are more likely to adopt conservative corporate policies. Therefore, one can expect firms with a Republican culture to assume corporate policies that are more in agreement with securities regulation which directly fall into the SEC's mandate. In other words, firms that contribute to the Republican Party more often than the Democratic Party are, on average, expected to violate the SEC regulations less frequently or intentionally. Consequently, if persecuted by the SEC, Republican firms are expected to receive lower monetary penalties and less severe sanctions against individuals associated with them since intent is less likely. We propose the following hypothesis to test this empirically:

H4: If prosecuted by the SEC, firms with a Republican culture receive lower penalties.

3. Data Description

In order to examine the relationship between political connectedness, political values and SEC enforcement actions, a sample is created which consists of firms included in the S&P Composite 500 index from 1995 to 2013 for a minimum of one year. The list of firms in the sample is then matched with the SEC's "Administrative Proceedings" and "Litigation Releases" for the same time period. Ninety-one cases are identified which directly involve a firm or at least one of the firm's senior management. Separately, each firm in the sample is matched with the PAC directly sponsored by the firm, if any. Eventually, 85 cases comprising 80 unique firms are selected with

market capitalization data in the year preceding the first action or settlement of the case (i.e., the case year).

The list of S&P 500 firms is obtained from the Compustat Index Constituents file. The SEC enforcement action data are retrieved directly from the SEC website. The political contribution data for PACs sponsored by each firm are retrieved from the Center for Responsive Politics (CRP) data files. The original data come from the Federal Election Commission (FEC).[5] The accounting information is obtained from the Compustat Fundamental Annual tables. Finally, the daily stock return and market return data, which are used for the event study analysis, are obtained from the Center for Security Prices (CRSP) files. Table 1 shows the summary statistics for the SEC enforcement cases included in the sample, the PAC contributions made by the firms, and the main control variables used in the regression specifications.

3.1. The SEC Enforcement Variables

The SEC enforcement action data are compiled directly from the administrative proceeding and litigation release documents provided by the SEC. For each case, we identify the type of enforcement action (administrative proceeding or litigation), the relevant dates on which the decisions or settlements are made, the list of senior managers prosecuted or sanctioned, the administrative or court orders, and any disgorgement of ill-gotten gains, civil penalties or criminal fines imposed on the firm or on top executives of the firm. The data are then aggregated for each case to create the main variables of interest. Litigation is a dummy variable which takes the value of one if a civil lawsuit is brought by the SEC against the firm in federal court, and is set to zero otherwise. Bar/suspension is a dummy variable which takes the value of one if an individual in the firm is barred from serving as an officer or director of a public company (either temporarily or permanently) or is suspended from appearing or practicing before the SEC as an accountant or an attorney (either temporarily or permanently), and is set to zero otherwise. Regulatory Period is the

[5] The data are available on http://www.opensecrets.org/.

number of months between the first enforcement action or settlement and the concluding action, if any. While most cases involve only one enforcement action (generally a settlement) on a single date, high-profile cases span several years.

Direct Costs are the natural logarithm of changes to the firm's pre-tax income in U.S.$ millions subsequent to a fraudulent activity or material misrepresentation by the firm as reported by the SEC. Total monetary penalties include disgorgements and imposed fines (civil penalties and criminal fines) in U.S.$ paid by the firm and its top executives according to the settlement agreement or the court order. The natural logarithm of penalties is used in the regression analysis.

3.1.1. The SEC Investigation and Enforcement Process

The SEC enforcement variables used in this paper are in line with the previous literature and related to the Commission's investigation and enforcement process. Feroz, Park, & Pastena (2008) study 188 accounting and auditing-related enforcement cases from 1982 to 1989. They examine the enforcement actions from the restatement event, which triggers the investigation, through the settlement, administrative proceeding or court order. They identify the nature of the accounting misstatement and its income effect, the duration of the violation and investigation periods, the type of action at settlement, and the enforcement against the auditors involved. In another study, Karpoff, Lee, & Martin (2008) use one of the largest samples of SEC enforcement actions, which consists of 788 enforcement actions initiated against U.S. firms by the SEC and DOJ from 1977 through 2006. Each "action" in their sample typically starts with a trigger event following a violation period. The event that triggers the action is generally initiated by the firm via self-disclosure, restatement, delayed SEC filings or similar actions. The trigger event is then followed by an informal inquiry or formal investigation initiated by the SEC or other federal agencies.

The SEC's investigation decision is initially handled by the Commission's staff which will present their recommendations to the SEC commissioners. The commissioners then decide whether to file for an administrative action or bring a civil lawsuit to the court and which penalties or sanctions to demand (SEC, 2014). Finally, the regulatory filing typically results in one or

multiple settlements and may be followed by additional lawsuits or DOJ sanctions and criminal penalties until the case is either closed or dismissed. Figure 1 shows the typical timeline of an enforcement action as depicted in Correia (2014). Karpoff, Lee, & Martin's database of enforcement actions identifies the type of violation, the type of proceeding, the number of respondents (CEOs, top executives and non-executive employees), and the type and amount of penalties and sanctions imposed on the firms and individual respondents. These data and variables are also used in subsequent studies (Kedia & Rajgopal, 2011; Correia, 2014).

3.2. Political Connection and Political Value Variables

Political contribution data are created from Committee (PACs), Candidate and PAC to Candidate data files provided by the CRP. The combined data file includes the information regarding each committee's contribution to any of the congressional (House or Senate) or presidential candidates. The file identifies the name and political party affiliation of the candidates as well as the dollar amount of the contributions. We aggregate the data to compile the average annual contributions by each firm's main PAC to each of the primary political parties (i.e., the Democratic and Republican parties) and independent candidates for the five years preceding the case year. We follow Correia (2014) and calculate the long-term PAC contribution variable as the five-year average of annual contributions. The five-year average PAC contribution is better able to capture long-term relationships between firms and politicians (when the aggregate contributions to both political parties and independent candidates are considered) or the political orientation of the firm (when the party contributions are considered separately).

3.2.1. Corporate PAC Contributions as Signals of Political Connections and Political Values

Campaign contributions from PACs are often used in the empirical literature to represent political connectedness (Milyo, Primo, & Groseclose, 2000). In this context, PAC contributions are either considered a form of "interested money", donations in the hope of influencing future policies, or a means by which firms "flex their muscles" to regulators (Gordon & Hafer, 2005). PAC contributions are currently governed by federal regulations established in 1976 which

restricts PACs' funding to donations by individuals, parties or other PACs. However, all "hard money" contributions are essentially derived from individual donors. Additionally, campaign contributions through PACs are subject to strict limits (Milyo, Primo, & Groseclose, 2000). Corporate PACs account for the major share of total campaign contributions by all types of PACs and their significance has increased over time compared to other types of PACs – namely, trade associations, membership organizations and health (T/M/H) PACs and labor PACs. However, total PAC contributions are still very small compared to direct "soft money", lobbying, and philanthropic expenditures. For that reason, Milyo, Primo, & Groseclose argue that the importance of corporate PAC contributions in determining political connections is overstated in the literature.

Nonetheless, contributions through corporate PACs could signal a firm's political connections as suggested by the theory. In other words, firms may not necessarily use PAC contributions to directly obtain political favours in the future. Instead, they could communicate their political connections and their willingness to fight the SEC in court. Therefore, PAC contributions may act as a viable signal even if their size is small in comparison to other types of political expenditures. For example, Correia (2014) finds a significant negative association between PAC contributions and the penalties imposed on firms and sanctions against individuals in enforcement actions. However, they find no meaningful relationship between lobbying expenditures and the penalties or sanctions. Similarly, Gordon & Hafer (2005) show that only "political" expenditures, rather than more general expenditures such as philanthropic donations, would effectively signal political connections. Finally, Hutton, Jiang, & Kumar (2014, 2015) show that although most firms and individuals donate to both Democratic and Republican Parties, leaning toward one of the major parties could indicate political orientation and values. We maintain that using PAC contributions as a proxy for political connections and political values is justified.

3.3. Control Variables

The firm-specific accounting variables, size, growth, return-on-assets (ROA) and leverage, are employed to mitigate the concern that these firm-level characteristics vary significantly among the firms in the sample which, in turn, would affect our results. Size is the natural logarithm of market

capitalization in U.S.$ millions. Market capitalization is the closing stock price multiplied by the number of shares outstanding at the end of the fiscal year prior to the case year. Growth is measured by the 3-year geometric average growth rate in net sales. ROA, the measure of profitability, is operating income before depreciation divided by total assets. Finally, leverage is calculated as the sum of long-term debt and debt in current liabilities scaled by total assets.

4. Empirical Analysis

This study employs Logistic and Ordinary Least Squares (OLS) cross-sectional regression models. In litigation and bar/suspension regressions in which the dependent variable is a dummy variable, the models are estimated with the logistic regression approach. On the other hand, in regressions in which the dependent variable is a monetary penalty, the models are estimated with the OLS regression approach. Finally, event study methodology is used in order to further investigate whether the resolution of SEC cases and their correlation with political contributions was anticipated by investors. The return of each individual stock is regressed on the return of the market portfolio and the estimated coefficients are used to calculate the cumulative abnormal returns over the event window. The event window includes the 61 days around each enforcement or settlement date, including the resolution date itself, pertaining to each SEC case.

4.1. The Choice of SEC Enforcement Action

After a violation is detected and investigated by the SEC, the Commission is faced with a major decision which involves the choice between an administrative proceeding or filing a civil lawsuit against the firm in federal court. Gadinis (2012) finds that the SEC is more likely to rely on administrative proceedings rather than civil lawsuits against larger firms in the financial industry. He argues that against larger firms and defendants with sophisticated legal teams, the Commission may choose less aggressive actions through administrative proceedings in order to be able to quickly turn its limited resources to other cases. Correia (2014) shows that firms with long-term political connections, which have had restated their financial statements, are less likely to be

prosecuted by the SEC. The Commission's officials could favour connected firms if they seek to increase their chances of career advancement. We would expect the SEC to make a similar decision with respect to an administrative rather than court proceeding against politically connected firms.

On the other hand, the SEC could litigate cases against well-known firms with substantial bargaining power or political connections. This would showcase the Commission's action against fraud. In order to test the SEC's choice between the two venues, administrative proceeding or litigation, and its relationship with bargaining power and political connections, we run the following logit regression:

$$\text{Logit}(Litigation_{it}) = \alpha + \beta_1 PAC(T)_{i,t-1} + \beta_2 Size_{i,t-1} + \beta_3 PAC(T)_{i,t-1} \times Size_{i,t-1} + \beta_4 Control_{i,t-1} + \varepsilon_{it} \quad (1)$$

The dependent variable takes the value of one if a civil lawsuit is brought by the SEC against the firm or its executives in federal court, and is set to zero otherwise. $PAC(T)_{i,t-1}$ is the natural logarithm of the 5-year average total annual political contributions by firm i's PAC from year $t-5$ to year $t-1$; that is:

$$PAC(T)_{i,t-1} = \ln\left(\sum_{k=1}^{K} Annual\_PAC(T)_{i,t-k}/K\right);$$

where $K = 5$ and t is the case year.[6] $Size_{i,t-1}$ is the natural logarithm of firm i's market capitalization in year $t-1$. We follow the literature and control for the size of the harm and complexity of violations and several firm characteristics (Karpoff, Lee, & Martin, 2008; Correia, 2014; Hutton, Jiang, & Kumar, 2015). Specifically, we include a dummy variable, Long, for whether the regulatory period is longer than one year. We also control for direct costs of the violations to the firm, growth opportunities, return on assets, and leverage, as explained in the previous section. Whether the SEC would litigate violations that are more sophisticated or have

[6] Substituting the 3-year average annual contributions does not materially change the results presented in this paper.

caused more harm to shareholders is an empirical question. The SEC may choose an administrative proceeding for most complicated violations to engage in "rulemaking by adjudication". However, Gadinis (2012) finds that the Commission distributes the cases evenly between administrative and court proceedings irrespective of the size of the harm or complexity of the violations.

Table 2 presents the results of the probability of litigation regressions. The probability that the SEC files a civil lawsuit against a firm in violation is lower for larger firms. This supports the finding of Gadinis (2012). The coefficient estimate for firm size ranges from –0.2264 to –0.7468 and is statistically significant in most specifications. In particular, a $1 billion increase in market capitalization around the $10.85 billion average value is estimated to reduce the odds[7] of litigation between 4.10 to 12.89 percent. On the other hand, the estimates of the effect of long-term total PAC contributions on the probability of litigation is not significant. The effect is negative when the interaction between PAC contributions and firm size is included in the regressions and is positive in regressions without the interaction variable. Finally, the interaction between firm size and PAC contributions is positively associated with the probability of litigation, but the coefficients are only statistically significant at the 10% level. These results indicate that although the SEC is less likely to take a larger firm to court, the effect is mitigated if the firm is politically connected. This could be due to the added complexity of cases which involve large political connected firms.

4.2. PAC Contributions, Size and Penalties

Subsequent to an enforcement action, the SEC could impose monetary penalties on the firm or its individual defendants, compel them to disgorge or repay ill-gotten gains, bar the individual defendants from serving as an officer or director of a public company, or suspend them from practicing law or professional accounting. Firstly, penalty theory suggests that the size and severity of the penalty should be in proportion to the seriousness of the violation (Becker, 1968). In the

[7] If $p = Prob(Litigation_{it} = 1)$, then the odds of litigation will be equal to $\frac{p}{1-p}$.

case of securities violations, severe penalties would be more likely if the potential harm caused by the violations to investors is higher. Therefore, the monetary value of the penalties should be positively correlated with the size of the harm. Moreover, sanctions against individual defendants are expected when extreme recklessness or intent is likely. The monetary value of the penalties should also depend on the ability of the firm or defendants to pay (Waldfogel, 1995). Specifically, larger firms are expected to receive higher disgorgement orders.

However, a firm could utilize its bargaining power or political connections to reduce the penalties. Gadinis (2012) reports that the employees of big brokers and dealers are likely to receive temporary or permanent bars from the industry. Correia (2014) finds that connected firms on average receive lower monetary penalties and less sanctions against their employees compared to non-connected firms. Political connections could signal a firm's willingness to fight the SEC or be used to put pressure on the Commission if it imposes harsh penalties on the firm. Moreover, politically-connected firms could use politicians' expertise to reduce the probability of being detected if they commit a fraud or alleviate penalties when the fraud is detected. Finally, SEC could seek harsher penalties when violations are more likely to be intentional. Inasmuch as political contributions indicate political culture and, consequently, determine the probability of committing securities fraud, Republican firms are expected to receive lower penalties.

We test our main hypotheses in this section by studying the relationship between penalties associated with each enforcement action in our sample and the explanatory variables discussed above – namely, political culture, political connections and firm size. First, we focus on sanctions against individual executives. Table 3 presents the results from the regressions of the bar or suspension penalties. The dependent variable takes the value of one if one of the defendants is barred from serving as an officer or director of a public company or suspended form professional practice at the end of the SEC enforcement action, and is set to zero otherwise. The models are estimated using logit regressions. Panel A of the table examines the relationship between bar/suspension penalties and political connections and firm size. The regression models are variations of the model in equation (1). Consistent with the results reported by Gadinis (2012), we

find that the probability of a bar or suspension penalty is lower for larger firms. In the model with the full set of control variables, the coefficient estimate is -1.6860 and is statistically significant at the 5% level. That is, ceteris paribus, a $1 billion increase in market capitalization is estimated to reduce the odds of a bar or suspension penalty by 26.77 percent. We do not find a clear relationship between bar/suspension penalties and total PAC contributions, our measure of political connections. However, in regression specifications which include the $PAC(T)$ variable and its interaction with firm size, we find a similar pattern to the probability of litigation regressions. That is, defendants in politically-connected firms are less likely to receive a bar or suspension penalty, but only for smaller firms. Both effects are statistically significant at the 10% level.

Bar or suspension penalties are also positively and significantly affected by the direct costs of violations, which measure the size of the harm to investors. However, the effect of direct costs becomes insignificant in regression specifications which include the long dummy variable. The enforcement cases which take longer to resolve involve multiple defendants and complex violations. Moreover, intent is more likely in complex violations. Thus, the defendants involved in complex violations are expected to receive more severe bar or suspension penalties. Our results support this argument. We further examine the association between the intention for misconduct and penalties imposed on individual defendants in regressions which include measures of political culture or ideology as the main explanatory variable. Specifically, we calculate $PAC(D)$ ($PAC(R)$) as the natural logarithm of the 5-year average annual political contributions by each corporate PAC to Democratic (Republican) candidates. The logit regression estimates are reported in Panel B of Table 3. We find that a Republican (Democratic) culture is negatively (positively) associated with the probability of a bar or suspension penalty. The coefficient estimates of $PAC(D)$ and $PAC(R)$ are statistically significant at the 5% level. In economic terms, an average $10 more annual contribution to Democratic candidates increases the odds of a bar or suspension penalty by 4.88%. Conversely, an average $10 more annual contribution to Republican candidates reduces the odds

of a penalty by 2.78%.[8] Firms in our sample on average donate $421 and $624 annually to Democrats and Republicans, respectively, over the 5-year period prior to each case year. Given that the unconditional probability of a bar or suspension penalty is 25.88%, the effect of a $10 additional contribution is economically significant.

As a robustness test, we reestimate the models by introducing a ratio variable. In particular, the PAC ratio for each corporate PAC is the 5-year average ratio of the annual political contributions to Republican candidates to the sum of contributions to both Republican and Democratic candidates. That is:

$$PAC\_Ratio_{i,t-1} = \ln\left(\sum_{k=1}^{K} \frac{Annual\_PAC(R)_{i,t-k}}{Annual_{PAC(R)_{i,t-k}} + Annual\_PAC(D)_{i,t-k}} / K\right);$$

where $K = 5$ and t is the case year. Additionally, we include a dummy variable which is set to one if a firm had no PAC contributions to either of the two major parties over the past 5-years, and zero otherwise. The results are presented in Panel C of Table 3. Consistent with the results presented earlier, the coefficient estimates of the ratio variable are negative and statistically significant at the 5% level. Taken together, these findings are consistent with political contributions to the Republican party being indicative of a Republican culture, which, consequently, would make the intent for securities market violations less likely (H4).

Next, we investigate how monetary penalties are affected by PAC contributions. Monetary penalties include disgorgement of ill-gotten payments and civil or criminal fines. According to the penalty theory, monetary penalties should depend more on the ability of the firm or defendants to pay rather than other factors, such as the size of the harm or intentionality (see for example,

[8] The change in odds are calculated using the coefficient estimates in column (6) of Table 3, Panel B as follows: The average value of $PAC(D)$ is 6.0423 (see Table 1). A $10 additional average annual contribution to Democrats would increase the logit value by $2.0302 \times [\ln(e^{6.0423} + 10) - 6.0423] = 0.0477$. Thus, the odds would change by $e^{0.0477} - 1 = 4.88\%$. Similarly, the average value of $PAC(R)$ is 6.4355. A $10 additional average annual contribution to Republicans would reduce the logit value by $-1.7703 \times [\ln(e^{6.4355} + 10) - 6.4355] = -0.0282$. Thus, the odds would change by $e^{-0.0282} - 1 = -2.78\%$.

Waldfogel, 1995). This argument should hold particularly for disgorgement actions. Historically, the SEC has sought the disgorgement of illegal profits in enforcement actions to discourage similar misconduct in the future rather than to obtain monetary remedies for private individuals harmed by the violations (Ellsworth, 1977). For example, in its Annual Report to Congress for the year 1975, the Commission states that:

> The SEC's primary function is to protect the public from fraudulent and other unlawful practices and not to obtain damages for injured individuals. Thus, a request that disgorgement be required is predicated on the need to deprive defendants of profits derived from their unlawful conduct and to protect the public by deterring such conduct by others. (SEC, 1975, pp. 97-98)

Therefore, we expect disgorgement to be positively affected by the ability of the firm or defendants to pay and negatively by the ability of the SEC to win the case in federal court. Table 4 examines the association between political connections, firm size and disgorgement. The models are estimated using OLS linear regressions. All monetary penalty regressions include the litigation dummy as an explanatory variable since higher penalties are expected in litigation cases. The results from disgorgement regressions support our initial conjecture. Specifically, we find that larger firms on average pay higher disgorgement although the effect is only marginally significant. On the other hand, the disgorgement amount is lower for politically connected firms. The coefficient estimates range from -0.2278 to -0.3312 and are statistically significant at the 10% level or above. That is, a 1% increase in long-term PAC contributions reduces disgorgement by 0.23% to 0.33%. This supports our hypothesis regarding the benefits of political connections (H1) and the finding of Correia (2014). Disgorgement is also positively associated with litigation and long regulatory period.

Table 5 reports the results from OLS regressions of imposed fines on our main explanatory variables. Imposed fines consist of both civil and criminal fines. The association between imposed fines and political connections, political culture, and size is less obvious than the other types of penalties. On the one hand, similar to other monetary penalties, fines should be affected by the

ability of the firm or defendants to pay. On the other hand, fines could reflect the complexity of violations, harm to investors, and intentionality of misconduct. In order to further investigate each of these effects, we estimate three separate series of imposed fines which are presented in Panels A, B and C. The results are consistent with our earlier findings regarding the factors that influence the probability of a bar or suspension penalty, but the coefficient estimates are generally not statistically significant. Nevertheless, we find that a Republican culture, measured either using the long-term PAC contributions to Republican candidates or the ratio of contributions to Republican candidates to total contributions, is associated with lower fines. This provides further support for our hypothesis that since the Republican ideology promotes market discipline, intent is less likely in securities violations committed by firms or individuals associated with a Republican culture.

4.3. Additional Analysis

Our results thus far indicate that political contributions made through corporate PACs act as a signal for political connections and political culture. The SEC considers these signals as a firm's intention to fight the Commission's decisions or an intention for misconduct which, consequently, influences the penalties imposed on the firm or individuals associated with the firm. If these impacts are recognized by investors, then we would expect the market to react to enforcement actions accordingly. However, identifying the event that triggers an investigation which, eventually, leads to an enforcement action is not always possible. The SEC does not provide the information about the decision to investigate a firm until an enforcement action is filed and the firm has the discretion on whether to disclose this information. Therefore, an analysis of the market reaction to enforcement actions may not be an unbiased estimate of the expected penalties or enforcement costs. Nonetheless, we examine market reaction to the filing of SEC enforcement actions to identify any systematic patterns across different levels of our explanatory variables consistent with the observed variation in penalties.

We measure market reaction by the mean cumulative abnormal returns (CARs) around all the dates associated with each particular case. The CARs are estimated using the market model. The mean CARs for multiple event windows are presented in Table 6. The abnormal returns are

computed for 80 SEC enforcement actions for which the return data are available. Figure 2 plots the CARs during the 101-day period around the event date starting at 50 days before the filing of an enforcement action. The Table shows a cross-sectional difference between the SEC enforcement cases for the mean CAR (-30, -1) and CAR (-30, +30) and the magnitude of market reaction is 1.58% and 2.41%, respectively. However, time-series test statistics are not significant for any of the reported event windows. Further cross-sectional regression analysis (untabulated) does not show any particular pattern in the mean CARs. One possible explanation is that the SEC enforcement actions are typically filed years after the initial violations. Therefore, the market could have already incorporated the impact of PAC contributions and penalties on returns prior to the administrative or court proceedings.

5. Conclusion

In this paper, we examine whether corporate PAC contributions affect penalties resulting from SEC enforcement actions. On the one hand, firms could use political contributions to communicate their willingness to challenge the SEC's enforcement decisions (Gordon & Hafer, 2005). On the other hand, political contributions could indicate the firm's political culture which could affect the intention for misconduct (Hutton, Jiang, & Kumar, 2015). Consistent with the argument that the Republican ideology promotes market discipline, we find that firms with a Republican culture receive lower penalties in SEC enforcement actions. In particular, individual defendants associated with Republican firms are significantly less likely to receive a bar or suspension penalty. Our analysis is based on a small but recent sample of SEC enforcement actions against S&P 500 firms which includes cases from 1996 to 2014.

Our results also show that total PAC contributions and firm size, both proxies for a firm's ability to fight the SEC's enforcement decisions, reduce enforcement costs. Cases which involve larger firms are less likely to be assigned to court. Moreover, larger firms receive lower fines and their executives are less likely to be the subject of a bar or suspension penalty. Political connections, on the other hand, are effective in reducing disgorgement.

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7. Appendix: Tables

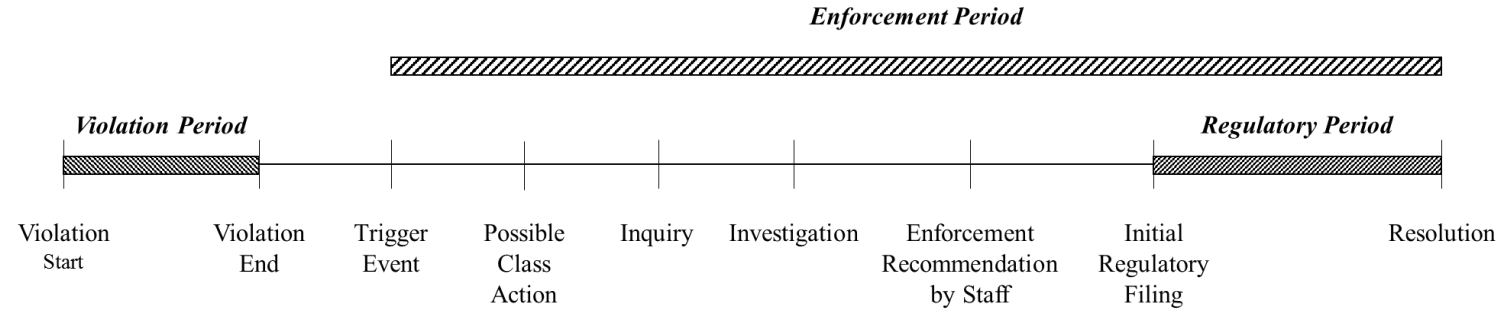
Table 1: Summary Statistics

This table contains descriptive statistics for PAC contributions, SEC enforcement actions and firm characteristic variables for the sample of SEC enforcement cases. The sample includes 85 observations (i.e., administrative actions) and 80 unique firms. Panel A reports the statistics for the natural logarithm of the 5-year average political contributions in U.S.$ by each firm's political action committee (PAC) and the 5-year average number of candidates supported by each PAC. The contributions are reported separately for the Democratic, Independent and Republican candidates. Panel B reports the statistics for the regulatory period in months, the number of individual respondents and the natural logarithm of the direct costs. The direct costs are the pre-tax charges to the firm's income in U.S.$ millions subsequent to a fraudulent activity or material misrepresentation as reported by the SEC. This panel also shows the number and the percentage of cases which involve litigation (civil lawsuit in federal court) and a bar or suspension imposed on individual respondents, respectively. Panel C reports the statistics for the natural logarithm of the different types of penalties imposed on the firms or individual respondents. The penalties include disgorgement of ill-gotten gains and civil or criminal fines in U.S.$. Panel D reports the statistics for firm level variables. Size is the natural logarithm of market capitalization in U.S.$ millions. Growth is the 3-year geometric average in net sales. Profitability, measured using return on assets (ROA), is operating income before depreciation divided by total assets. Leverage is the sum of long-term debt and debt in current liabilities divided by total assets.

Panel A – Long-Term PAC Contributions					
Variable	Mean	Median	Std. Dev.	Min	Max
5-Year Average PAC Contributions					
Democrats	6.0423	8.7160	5.0785	0.0000	12.5787
Independent	1.2329	0.0000	2.8137	0.0000	9.1050
Republicans	6.4355	9.5324	5.3892	0.0000	12.7219
Total	6.7041	9.7851	5.6056	0.0000	13.2988
5-Year Average Number of PAC Contributions					
Democrats	27.6500	5.6667	53.2178	0.0000	253.4000
Independent	0.2353	0.0000	0.5855	0.0000	3.0000
Republicans	42.4839	9.8000	65.5793	0.0000	261.6000
Total	70.1347	18.2000	116.5639	0.0000	492.2000
Panel B – SEC Enforcement Actions					
Variable	Mean	Median	Std. Dev.	Min	Max
Regulatory Period	10.4922	0.0000	23.7827	0.0000	103.9333
Number of Respondents	1.0824	0.0000	1.8271	0.0000	8.0000
Direct Costs	6.9174	8.8537	5.9521	0.0000	15.4642
Variable	N			Percentage	
Litigations	59			69.41%	
Bars/Suspensions	22			25.88%	

Table 1 – Continued

Panel C – Monetary Penalties					
Variable	Mean	Median	Std. Dev.	Min	Max
Disgorgement					
The Firm	3.8104	0.0000	6.8385	0.0000	18.9917
Executives	4.0615	0.0000	6.4729	0.0000	21.6791
Total	7.6681	9.4242	7.6481	0.0000	21.6791
Imposed Fines					
The Firm	7.9713	12.3239	7.6894	0.0000	19.5193
Executives	4.2811	0.0000	6.0490	0.0000	16.2337
Total	9.6882	12.7657	7.0610	0.0000	19.5231
Total Monetary Penalties					
The Firm	9.1343	12.8992	7.8419	0.0000	19.5193
Executives	4.9236	0.0000	6.8427	0.0000	21.6804
Total	11.1354	13.8643	7.0814	0.0000	21.7181
Panel D – Firm Characteristics					
Variable	Mean	Median	Std. Dev.	Min	Max
Size (Market Capitalization)	9.2922	9.2377	1.7383	4.3047	12.8815
3-Year Growth in Sales	0.0612	0.0524	0.1520	-0.3696	0.7089
Return-On-Assets (ROA)	0.1272	0.1288	0.0839	-0.2142	0.3269
Total Book Leverage	0.2773	0.2237	0.2080	0.0000	1.1991



This figure shows the typical timeline of an SEC enforcement action. The figure is a slight modification of Figure 1 in Karpoff, Lee, & Martin (2008) as depicted in Correia (2014).

Figure 1: Timeline of an SEC Enforcement Action

Table 2: Probability of Litigation

This table reports the results from logistic cross-sectional regressions of the litigation dummy variable on the total PAC contributions, firm size and their interaction, and a set of case- and firm-level control variables. The dependent variable takes the value of one if a civil lawsuit is brought by the SEC against the firm in federal court, and is set to zero otherwise. The explanatory and control variables are explained in Table 1. The coefficient estimates and *Chi-square* statistics (appearing below in parentheses) are reported. *, **, and *** denote the statistical significance of the coefficients at the 10%, 5%, and 1% levels, respectively.

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	3.1624**	7.1414**	3.0640*	7.2201**	1.9200	6.4522*	1.7841	5.8157*
	(4.76)	(5.51)	(3.70)	(4.88)	(1.15)	(3.65)	(1.01)	(3.01)
PAC Contribution (T)	0.0714	-0.4706	0.0798	-0.4531	0.0833	-0.5328	0.0928	-0.4621
	(2.16)	(2.25)	(2.11)	(1.96)	(2.21)	(2.51)	(2.66)	(1.84)
PAC (T) × Size		0.0578*		0.0569*		0.0659*		0.0592
		(2.99)		(2.74)		(3.38)		(2.67)
Size	-0.2989*	-0.7468**	-0.3043*	-0.7453**	-0.2401	-0.7358**	-0.2264	-0.6748*
	(3.34)	(4.83)	(2.80)	(4.34)	(1.62)	(3.97)	(1.40)	(3.30)
Long							1.9716*	1.8132
							(3.16)	(2.65)
Direct Costs					0.0636	0.0779*	0.0315	0.0480
					(2.00)	(2.80)	(0.43)	(0.94)
Growth			1.6387	0.9683	2.0055	1.2654	1.9023	1.2593
			(0.72)	(0.24)	(0.96)	(0.37)	(0.78)	(0.32)
ROA			-0.6490	-0.9142	-0.0930	-0.2270	-0.2395	-0.1617
			(0.04)	(0.07)	(0.00)	(0.00)	(0.00)	(0.00)
Leverage			0.2959	-0.3389	0.3544	-0.3365	0.1395	-0.3201
			(0.05)	(0.05)	(0.06)	(0.05)	(0.01)	(0.04)
R^2	4.65%	8.57%	5.50%	9.01%	7.75%	12.07%	12.62%	15.83%
N	85	85	85	85	85	85	85	85

Table 3: Probability of Bar/Suspension

This table reports the results from logistic cross-sectional regressions of the bar/suspension dummy variable. This variable takes the value of one if an individual in the firm is barred from serving as an officer or director of a public company (either temporarily or permanently) or is suspended from appearing or practicing before the SEC as an accountant or an attorney (either temporarily or permanently), and is set to zero otherwise. In Panel A, the dependent variable is regressed on the total PAC contributions, firm size and their interaction, and a set of case- and firm-level control variables.

Panel A – Total PAC Contributions								
Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	4.7995***	9.2827**	3.9577**	8.7318**	1.7155	8.4670*	2.7871	11.5316*
	(7.15)	(5.94)	(4.17)	(4.78)	(0.64)	(3.60)	(1.28)	(3.55)
PAC Contribution (T)	0.0522	-0.5257	0.0241	-0.5459	0.0230	-0.8453*	0.0717	-0.9238*
	(0.90)	(2.06)	(0.14)	(2.17)	(0.12)	(3.71)	(0.72)	(3.06)
PAC (T) × Size		0.0679		0.0667		0.1004**		0.1191*
		(2.47)		(2.37)		(3.91)		(3.42)
Size	-0.6929***	-1.2451***	-0.5682**	-1.1207**	-0.4888*	-1.2910**	-0.6256**	-1.6860**
	(10.12)	(6.98)	(5.61)	(5.44)	(3.82)	(5.73)	(4.15)	(4.86)
Long							2.6807***	2.9313***
							(10.11)	(8.87)
Direct Costs					0.1549**	0.1841***	0.0690	0.0801
					(6.22)	(7.67)	(1.00)	(1.17)
Growth			0.6930	0.4510	1.1781	0.9233	1.2787	1.3700
			(0.14)	(0.06)	(0.42)	(0.23)	(0.36)	(0.40)
ROA			-3.6546	-4.2608	-2.3141	-3.4539	-2.9255	-3.8650
			(0.85)	(1.12)	(0.36)	(0.75)	(0.46)	(0.74)
Leverage			1.0657	0.4028	1.1401	0.1660	0.9903	-0.0566
			(0.53)	(0.07)	(0.56)	(0.01)	(0.28)	(0.00)
R^2	15.43%	18.24%	16.90%	19.52%	24.07%	28.27%	34.35%	37.85%
N	85	85	85	85	85	85	85	85

Table 3 – Continued

In Panel B, the dependent variable is regressed on the PAC contributions to the Democratic and Republican parties, firm size and the set of control variables. In Panel C, the dependent variable is regressed on the ratio of PAC contributions to the Republican Party, firm size and the set of control variables. The ratio is calculated as PAC contributions to the Republican Party divided by the sum of contributions to the Democratic and Republican parties. A dummy variable, No PAC Contributions, is also included which is set to one if the firm has no PAC contributions in the five years preceding the administrative action, and zero otherwise. The explanatory and control variables are explained in Table 1. The coefficient estimates and *Chi-square* statistics (appearing below in parentheses) are reported. *, **, and *** denote the statistical significance of the coefficients at the 10%, 5%, and 1% levels, respectively.

Panel B – PAC Contributions by Political Party						
Variable	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	5.8309***	5.6963**	5.6627***	6.0871**	3.1320	4.7080
	(9.42)	(6.10)	(6.68)	(4.85)	(1.78)	(2.58)
PAC Contribution (D)	1.7149**	1.9702**	1.6783**	2.0325**	1.8087**	2.0302**
	(5.50)	(5.66)	(4.66)	(5.18)	(4.72)	(5.11)
PAC Contribution (R)	-1.5472**	-1.7133**	-1.5247**	-1.7504**	-1.6452**	-1.7703**
	(5.05)	(4.99)	(4.39)	(4.66)	(4.45)	(4.65)
Size	-0.8217***	-0.9532***	-0.7707***	-1.0092***	-0.6701**	-0.8986**
	(12.58)	(10.38)	(8.27)	(7.04)	(6.04)	(5.80)
Long		3.3398***		3.3692***		2.9263***
		(14.39)		(14.02)		(9.46)
Direct Costs					0.1656**	0.0749
					(6.53)	(1.05)
Growth			0.4178	0.7225	0.7385	0.6981
			(0.05)	(0.10)	(0.16)	(0.09)
ROA			-2.1558	0.2196	-0.1985	0.6219
			(0.24)	(0.00)	(0.00)	(0.02)
Leverage			0.0633	-0.4550	-0.0931	-0.5134
			(0.00)	(0.05)	(0.00)	(0.07)
R^2	22.06%	37.93%	22.30%	38.07%	29.33%	38.85%
N	85	85	85	85	85	85

Table 3 – Continued

Panel C – The Ratio of PAC Contributions to the Republican Party						
Variable	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	11.2383***	12.1379***	10.7965***	12.5834***	9.2853**	11.3622**
	(11.03)	(9.22)	(7.66)	(6.91)	(5.21)	(5.68)
PAC Contribution Ratio	-7.8376**	-8.6904**	-7.6603**	-8.8263**	-9.0764**	-9.3038**
	(5.51)	(5.38)	(4.64)	(4.95)	(5.29)	(5.18)
No PAC Contribution	-5.6787**	-6.9582***	-5.4301**	-7.1844**	-6.3908**	-7.3024**
	(6.45)	(6.97)	(4.96)	(5.89)	(5.60)	(5.98)
Size	-0.7843***	-0.8838***	-0.7300***	-0.9067***	-0.6466**	-0.8152**
	(12.51)	(10.25)	(8.35)	(7.09)	(6.16)	(5.90)
Long		3.2819***		3.2941***		2.8246***
		(14.63)		(14.38)		(9.49)
Direct Costs					0.1727***	0.0851
					(6.96)	(1.35)
Growth			0.3910	0.6996	0.7016	0.6983
			(0.04)	(0.09)	(0.14)	(0.09)
ROA			-2.2995	-0.4684	0.0341	0.3494
			(0.27)	(0.01)	(0.00)	(0.00)
Leverage			0.1261	-0.3830	-0.1334	-0.5347
			(0.01)	(0.04)	(0.01)	(0.07)
R^2	21.77%	37.62%	22.04%	37.74%	29.61%	38.75%
N	85	85	85	85	85	85

Table 4: Disgorgement

This table reports the results from OLS cross-sectional regressions of the disgorgement variable on the total PAC contributions, firm size and their interaction, and a set of case- and firm-level control variables. The dependent variable is total disgorgement imposed on the firm or individual respondents by the SEC or federal court. The explanatory and control variables are explained in Table 1. The coefficient estimates and heteroskedasticity-consistent *t*-statistics (appearing below in parentheses) are reported. *, **, and *** denote the statistical significance of the coefficients at the 10%, 5%, and 1% levels, respectively.

Variable	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	-1.5861	-3.7883	-2.6109	-4.0148	-1.9381	-0.9757
	(-0.41)	(-1.05)	(-0.59)	(-0.96)	(-0.37)	(-0.22)
PAC Contribution (T)	-0.2708**	-0.2278*	-0.3299**	-0.2677*	-0.3312**	-0.2623*
	(-2.16)	(-1.82)	(-2.13)	(-1.78)	(-2.15)	(-1.79)
Size	0.5594	0.7379*	0.7182	0.8290*	0.6783	0.6537
	(1.35)	(1.88)	(1.49)	(1.78)	(1.33)	(1.41)
Litigation	8.4588***	7.3131***	8.5539***	7.4137***	8.6303***	7.5724***
	(6.75)	(5.33)	(6.71)	(5.34)	(6.73)	(5.54)
Long		5.5810***		5.5213***		6.5689***
		(4.22)		(4.24)		(4.44)
Direct Costs					-0.0407	-0.2000
					(-0.30)	(-1.48)
Growth			-3.2539	-3.0287	-3.4216	-3.8100
			(-0.70)	(-0.68)	(-0.73)	(-0.85)
ROA			-1.8988	-1.4336	-2.2604	-3.1215
			(-0.21)	(-0.14)	(-0.25)	(-0.33)
Leverage			1.1547	-0.1555	1.1265	-0.5425
			(0.34)	(-0.05)	(0.33)	(-0.18)
R^2	26.11%	33.43%	26.74%	33.78%	26.83%	35.52%
N	85	85	85	85	85	85

Table 5: Imposed Fines

This table reports the results from OLS cross-sectional regressions of the imposed fines variable. This variable is total civil or criminal fines imposed on the firm or individual respondents by the SEC or federal court. In Panel A, the dependent variable is regressed on the total PAC contributions, firm size and their interaction, and a set of case- and firm-level control variables. In Panel B, the dependent variable is regressed on the PAC contributions to the Democratic and Republican parties, firm size and the set of control variables. In Panel C, the dependent variable is regressed on the ratio of PAC contributions to the Republican Party, firm size and the set of control variables. The ratio variable is explained in Table 3. The explanatory and control variables are explained in Table 1. The coefficient estimates and heteroskedasticity-consistent *t*-statistics (appearing below in parentheses) are reported. *, **, and *** denote the statistical significance of the coefficients at the 10%, 5%, and 1% levels, respectively.

Panel A – Total PAC Contributions				
Variable	(1)	(2)	(3)	(4)
Intercept	11.5330***	19.2811***	-0.7037	0.1338
	(2.71)	(4.48)	(-0.19)	(0.04)
PAC Contribution (T)	0.0335	-1.2046	-0.1375	-0.2584
	(0.21)	(-1.65)	(-1.11)	(-0.50)
PAC (T) × Size		0.1339*		0.0131
		(1.74)		(0.26)
Size	-0.2227	-1.1236**	0.5174	0.4287
	(-0.43)	(-2.12)	(1.31)	(1.13)
Litigation			10.9788***	10.9269***
			(9.90)	(9.81)
Long			3.2173***	3.1941***
			(2.65)	(2.70)
Direct Costs			-0.1524	-0.1482
			(-1.41)	(-1.33)
Growth			0.0219	-0.0892
			(0.01)	(-0.03)
ROA			-5.6461	-5.7446
			(-0.75)	(-0.75)
Leverage			0.1855	0.0150
			(0.08)	(0.01)
R^2	0.24%	3.43%	56.47%	56.50%
N	85	85	85	85

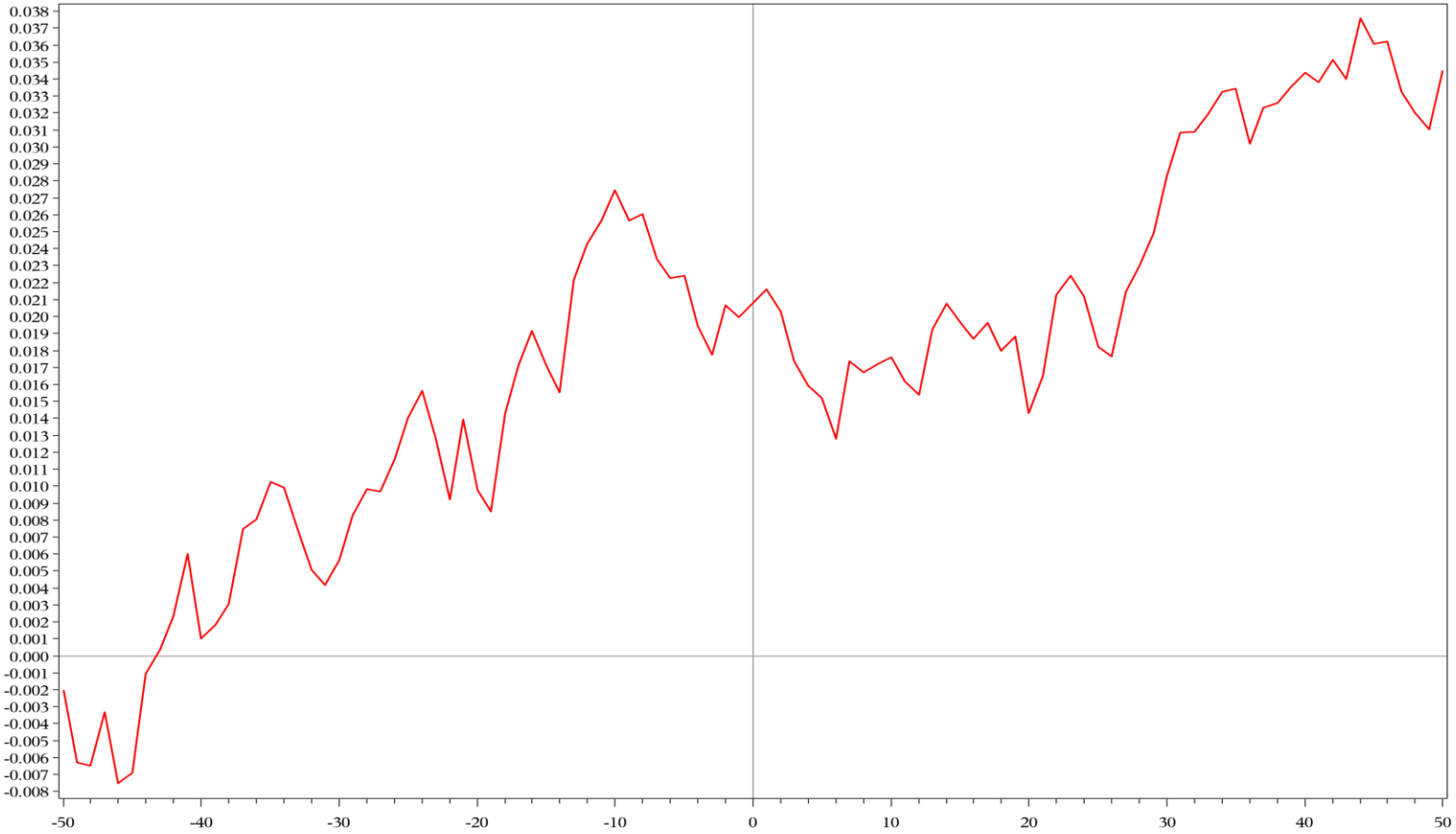
Table 5 – Continued

	Panel B – PAC by Party		*Panel C – Ratio of PAC*	
Variable	(2)	(3)	(4)	(5)
Intercept	12.9425***	0.5720	21.0857***	4.2183
	(3.04)	(0.15)	(2.92)	(0.64)
PAC Contribution (D)	2.0468	1.1946		
	(1.41)	(0.99)		
PAC Contribution (R)	-1.8706	-1.2358		
	(-1.38)	(-1.09)		
PAC Contribution Ratio			-11.8147*	-6.7827
			(-1.77)	(-1.17)
No PAC Contribution			-8.1380*	-3.2913
			(-1.71)	(-0.79)
Size	-0.3857	0.3537	-0.3796	0.3012
	(-0.74)	(0.90)	(-0.77)	(0.80)
Litigation		10.9166***		10.8634***
		(9.74)		(9.67)
Long		3.0928**		3.0446**
		(2.64)		(2.59)
Direct Costs		-0.1411		-0.1344
		(-1.33)		(-1.27)
Growth		-0.1752		-0.1064
		(-0.07)		(-0.04)
ROA		-3.6262		-2.8725
		(-0.53)		(-0.41)
Leverage		-0.5316		-0.6303
		(-0.24)		(-0.29)
R^2	2.52%	57.26%	3.27%	57.34%
N	85	85	85	85

Table 6: Market Reaction to the SEC Enforcement Events

This table reports the mean cumulative abnormal returns (CARs) for multiple event windows around 80 SEC Enforcement events where the return data are available. The CARs are calculated using the market model. For cases with more than one enforcement event, the CARs are averaged over the multiple events. The table also reports several time-series and cross-sectional test statistics for the significance of the CARs. Rank *Z*-statistics (time-series) and Wilcoxon *W*-statistics (cross-sectional) are associated with nonparametric tests. *, **, and *** denote the statistical significance of the CARs at the 10%, 5%, and 1% levels, respectively.

Event Window	**Mean Cumulative Abnormal Returns**	**Time-Series Standard Deviation Test *t***	**Cross-Sectional Test *t***	**Rank Test *Z***	**Wilcoxon Signed-Rank Test *W***
(-30, -1)	1.58%	1.060	1.355*	0.829	289.000*
(-10, -1)	-0.57%	-0.664	-0.871	-0.616	-178.00
(-5, -1)	-0.23%	-0.386	-0.463	0.248	-33.000
(-3, -1)	0.05%	0.106	0.141	0.402	46.000
(0, +1)	0.16%	0.427	0.405	0.707	156.000
(0, +3)	-0.26%	-0.476	-0.559	0.087	-149.00
(0, +5)	-0.48%	-0.715	-0.855	-0.187	-129.00
(0, +10)	-0.23%	-0.260	-0.311	-0.170	-124.00
(0, +30)	0.83%	0.551	0.752	0.910	138.000
(-1, +1)	0.09%	0.196	0.197	0.494	41.000
(-3, +3)	-0.21%	-0.291	-0.360	0.329	-25.000
(-5, +5)	-0.71%	-0.788	-0.934	0.029	-103.00
(-10, +10)	-0.81%	-0.647	-0.865	-0.548	-110.00
(-30, +30)	2.41%	1.137	1.368*	1.230	279.000*



This plot shows the event-period running average cumulative abnormal return. The event period ranges from 50 days before the SEC enforcement action through to 50 days after the action.

Figure 2: Cumulative Abnormal Returns (CARs) around the SEC Enforcement Events