May 13, 2015

Kelly Gorman Deputy Director, Enforcement Branch Ontario Securities Commission

Re: OSC Staff Consultation Paper 15-401

Dear Ms. Gorman,

First let me apologize for the delay in making this submission. I hope you will consider this letter and attached research paper as input to your consultation on Paper 15-401. I have submitted a copy of the research paper, "A lobbying approach to evaluating the whistleblower provisions of the Dodd-Frank Reform Act of 2010", coauthored with Vishal Baloria (Boston College) and Carol Marquardt (Baruch College), by email. In this paper, we attempt to provide early evidence on the perceived benefits of the SEC whistleblower (WB) provisions contained within Dodd Frank. We believe that this paper is very relevant to your current debate.

Overall, we are very supportive of the proposed rules based on our research on the SEC experience. We would like to highlight several key findings of the paper that pertain to your consultation:

1. Independence of Reporting and Lobbying Firms

As you note in Section 10 of your consultation paper, you expect that registrant firms in Ontario are likely to raise concerns about the impact of the program on their internal compliance programs. We provide a summary of the comment letters received by the SEC in Table 1 of our study. We found that the most contentious issue, by far, was that WBs are not required to first report misconduct through company internal compliance systems before reporting to the SEC. 461 respondents directly commented on this aspect of the proposal, with opinion sharply divided between individual and corporate lobbyers. Individuals strongly supported the proposal as written, with 99% (75 out of 76) expressing positive views on this aspect of the provisions. The SEC received over 800 form letters, stating: "Whistleblowers should never be forced or encouraged to take their concerns to their potentially corrupt bosses first." However, corporate respondents unanimously disapproved of the proposal, with all 283 commenters expressing a negative view. These respondents argued that the new rules would undermine existing internal compliance programs. For example, one letter argued that the rules would have unintended consequences, "...first, by undermining internal compliance and reporting systems that allow responsible companies to comply with critical regulations and conduct themselves in an ethical manner; and second, by proposing an alternative system which fails to replace existing corporate reporting systems with any effective mechanism to ensure that companies obtain early warnings of burgeoning failures or frauds within their organizations."

We would like to highlight that in our study, we found that companies that lobbied against the SEC WB program had *weaker* internal compliance programs that those that did not lobby, calling into question claims these companies were making about the new program undermining their existing systems. In particular, relative to the programs of non-lobbying firms, the WB programs of lobbying firms had reduced emphasis on the importance of employee reporting of accounting and auditing fraud, and that the channels of reporting they provided to WBs were *less independent* than those of non-lobbying firms (i.e. less likely to allow the individual to report to an independent party



such as the audit committee or a third-party hotline and more likely to report directly to management.) This lack of independence of reporting highlights the advantage of reporting directly to the OSC / SEC, particularly when management is involved in the allegation. (These results are summarized on pages 16-28 and Table 3).

2. Other Characteristics of Lobbying Firms

We also found that firms lobbying against the proposals had a higher degree of potential agency conflict between management and shareholders. In particular, an entrenchment index that measures the ease with which managers can exercise their own preferences as opposed to those of outside shareholders was significantly higher for lobbying firms. Also, these firms were more likely to combine the role of CEO and Chairman of the Board. We also found that lobbying firms has been involved in more cases of alleged retaliation against WBs in the past than non-lobbying firms.

<u>3. Perceived Impact of New Rules</u>

We assessed the perceived impact of the new rules by examining stock market reactions around key regulatory events related to the SEC WB provisions (see pages 28-38 and Tables 4 and 5). We found that the overall market reaction to 21 WB events was significantly positive, suggesting that the new rules were perceived to provide net benefits to shareholders. We also found that the returns tended to be *more positive* for firms with weaker existing WB program and for firms with more entrenched management, suggesting that the new WB provisions provide net benefits through improving shareholder protection, consistent with the SEC intentions.

We also compared returns of U.S. firms to non-U.S. firms around the 21 events. We used non-U.S. firms as a benchmark for comparison as the new SEC WB provisions do not apply to them. We found that U.S. firms experienced significantly more positive returns overall, consistent with investors expecting the average U.S. firm to receive net benefits from the regulatory change (see Table 6).

We hope that you will consider these findings in your deliberations. Please feel free to contact me if you have any questions about our research.

Sincerely,

Christine Wiedman

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A Lobbying Approach to Evaluating the Whistleblower Provisions of the Dodd-Frank Reform Act of 2010

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A Lobbying Approach to Evaluating the Whistleblower Provisions of the Dodd-Frank Reform Act of 2010

We evaluate the net costs and benefits of the whistleblower (WB) provisions adopted under the Dodd-Frank Reform Act of 2010 by examining investor responses to events related to the proposed regulations. To increase the power of our tests, we focus our analysis on a sample of firms that lobbied against implementation of the WB provisions by submitting a comment letter to the SEC. Excess stock returns around events related to implementation of the WB rules are significantly more positive for lobbying firms than for similar non-lobbying firms; this effect is also more pronounced for lobbying firms with weaker existing WB programs and more entrenched management. We further find that the new WB regulation is value-increasing for the average U.S. firm. These results collectively suggest that investors expect the new WB provisions to provide net benefits by improving shareholder protection. Our paper informs the current debate over whether the new WB provisions are likely to achieve their intended objectives and extends the literatures on compliance and business ethics, whistleblowing, corporate lobbying, and the economic consequences of regulation.

Keywords: whistleblowing; Dodd-Frank; corporate lobbying; Code of Ethics; regulation.

Data availability: Data are available from the sources identified in the paper.

I. INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act (hereafter referred to as "Dodd-Frank"), enacted on July 21, 2010, established a whistleblower (WB) program with the intended goal of strengthening investor protection through greater deterrence of securities law violations and more effective and efficient regulatory enforcement on the part of the Securities and Exchange Commission (SEC). The program requires the SEC to pay an award to eligible WBs who voluntarily provide original information about a violation of the federal securities laws that leads to the successful enforcement of a covered action, with the awards ranging from 10% to 30% of monetary sanctions obtained, subject to a minimum threshold of \$1,000,000. The final rules also strengthen anti-retaliation protection for WBs, and, most controversially, allow WBs to report misconduct directly to the SEC without first reporting through company internal compliance and reporting systems.

The SEC released its proposed rules for implementing the Dodd-Frank whistleblower provisions on November 3, 2010 and invited public comment through December 17, 2010. Two main competing views about the likely impact of the new provisions on shareholders were expressed in over 500 comment letters submitted to the SEC. Proponents of the provisions argue that the WB program will improve shareholder protection by allowing the SEC to leverage its limited resources to create partnerships with insiders with critical knowledge of corporate misconduct, thereby providing benefits to investors. Opponents of the new rules claim that the new regulation will undermine companies' existing internal compliance systems, making it more difficult to detect and deter corporate fraud, which will be costly to shareholders. The final rules were adopted with slight modifications on May 25, 2011, by a narrow 3-2 voting margin, and became effective on August 12, 2011.¹

¹ As further indication of the controversy surrounding the proposal, on May 11, 2011 draft legislation was introduced at a hearing in the House Financial Services Subcommittee on Capital Markets, entitled "Legislative Proposal to Address Negative Consequences of the Dodd-Frank Whistleblower Provisions." The draft legislation requires employees to report fraud to their employers before they can receive a monetary reward for reporting it to the SEC. Investor and consumer groups lobbied against the draft legislation, but the SEC modified the final WB rules to allow the possibility of increased monetary awards if a WB first reports via internal channels instead of reporting directly to the SEC.

Given the potential ramifications for investors, employees, auditors, and other stakeholders, it is important to assess the relative costs and benefits of the new provisions. In this paper, we provide evidence on this question by examining investor responses around events related to the development and implementation of the WB provisions as part of the Dodd-Frank Reform Act. A maintained assumption of our analysis is that stock prices incorporate the expected costs and benefits of the new regulation based on available information. Cumulative positive (negative) excess stock returns around events positively related to the likelihood that the new rules will be implemented are consistent with the expectation that the new regulation will lead to net shareholder benefits (costs).

To increase the power of our tests, we focus our analysis on a subset of firms that are most likely to be affected by the regulation. Following prior research (Watts and Zimmerman 1978; Kelly 1985; Francis 1987; Ndubizu et al. 1993; Dechow et al. 1996; Ettredge et al. 2002; Hochberg et al. 2009; Hodder and Hopkins 2014), we identify firms that lobbied against strict implementation of the proposed rules via comment letter submissions to the SEC as those that are most likely to be affected. We thus use the term "lobbying" throughout the paper to refer specifically to comment letter submission, consistent with the usage of the term in the accounting literature.² We perform additional analyses of firms' other political activities by examining meetings with the SEC, lobbying expenditures, and financial contributions through political action committees (PACs) to help support this design choice.

We first provide descriptive data on the letters submitted to the SEC during the public comment period. We document that individuals overwhelmingly favored the proposed provisions, with 87% expressing positive views overall. In contrast, corporate managers

² In their seminal article developing the positive theory of accounting, Watts and Zimmerman (1978) were the first to examine corporate lobbying on accounting standards, where "corporate lobbying" signified submission of a public comment letter to the Financial Accounting Standards Board. Because this influential paper initiated a vast literature related to lobbying on accounting regulation, the term "lobbying" within the accounting literature is still viewed as synonymous with comment letter submission to accounting standard-setters or regulators. This contrasts with legal definitions of "lobbying" and "lobbyist" per state and federal laws, which are designed to regulate professional lobbyist contact with legislators (see, e.g., The Federal Regulation of Lobbying Act of 1946, The Lobbying Disclosure Act of 1995, The Honest Leadership and Open Government Act of 2007). To achieve consistency with prior accounting literature, we retain usage of the term "lobbying" throughout the paper to indicate comment letter submission to the SEC, except as indicated in Appendix B, where we perform a limited analysis of expenditures on professional lobbyist services as a robustness test.

unanimously opposed strict implementation of the provisions, expressing especially strong disapproval toward the provision allowing WBs to report potential violations directly to the SEC without first using internal compliance systems.

Next, we compare the firm characteristics of lobbying firms to those of a control sample of non-lobbying firms matched by size and industry. We focus on characteristics that represent potential sources of the costs and benefits of the new rules, such as the strength of firms' existing WB programs, the degree of agency conflict within the firm, and the degree of vulnerability to WB allegations.

To measure WB program strength, we first construct a firm-level index based on descriptions of the program provided within each firm's Code of Ethics. To help ensure content validity, we rely on recommendations provided in the International Chamber of Commerce (ICC) Guidelines on Whistleblowing (ICC 2008), which serve as a point of reference for firms wishing to establish strong WB programs, to develop our measure. We rate whistleblowing programs on three broad categories – program efficacy, independence of reporting, and protection provided to WBs – and calculate a total score capturing overall WB strength. We assess the construct validity of our index of WB program strength by comparing our scores to data obtained from several independent corporate compliance sources, including the Ethisphere Institute, the Society of Corporate Compliance and Ethics (SCCE), and the U.S. Department of Justice (DOJ). Our measure of WB program strength correlates in a predictable manner with these alternative assessments of corporate compliance, indicating that our index has good external construct validity.

We use Bebchuk et al.'s (2009) "E-index," as our main proxy for the degree of agency conflict within each firm, but also include CEO duality and the level of managerial stock ownership as additional measures. To measure vulnerability to WB allegations, we incorporate as control variables a wide set of potential determinants of WB targets, including internal control weaknesses, earnings restatements, idiosyncratic risk, discretionary accruals, prior WB claims, external monitoring measures, and firm growth.

We find that firms that lobbied against the implementation of the proposed WB provisions exhibited significantly weaker existing WB programs, relative to non-lobbying

firms matched by firm size and industry. In particular, we document that lobbying firms have significantly lower program efficacy and less independence of reporting than their matched controls. We also document that lobbying firms exhibit significantly higher levels of managerial entrenchment than their matched controls, as measured by Bebchuk et al.'s (2009) E-index, and have CEOs that are more likely to serve in dual roles as Chairman of the Board. We also report some evidence that lobbying firms are more vulnerable to WB allegations than non-lobbying firms.

We next evaluate investor's expectations of the net costs and benefits of the new WB rules using the Schipper and Thompson (1983) methodology to control for potential cross-sectional correlation in residuals due to the alignment of event dates. We identify relevant event dates by searching the SEC's website for press releases and congressional testimony directly related to development of the new WB provisions. We also include key legislative actions leading to the passage of the Dodd-Frank Reform Act in our list of relevant events. This process yields over 20 separate event dates, spanning the time period from March 2009 to August 2011. Cumulating returns across all event dates (with events likely to decrease the likelihood of implementation of the WB provisions reverse coded), we document significantly positive excess returns for the portfolio of lobbying firms relative to the portfolio of matched control firms. In addition, the results are stronger when the confounding effects of the passage of the Dodd-Frank Act are omitted from the analysis. These findings are consistent with the view that investors expect the new WB provisions to provide net benefits to shareholders.

To provide insight into the source of these expected benefits, we examine whether investor reactions vary cross-sectionally with lobbying firm characteristics. We find that event date excess returns tend to be more positive for firms with weaker existing WB programs and for firms with more entrenched management, suggesting that the new WB provisions provide net benefits through improving shareholder protection, consistent with SEC intentions.

One limitation of our analysis is that our results may not generalize beyond the sample of lobbying firms. That is, it is possible that these particular firms benefit from the new WB provisions, but the average firm does not. To address this issue, we again adopt the Schipper and Thompson (1983) methodology but now compare stock returns

for a portfolio of all U.S. firms to a market portfolio of non-U.S. firms, which would not be subject to the new WB provisions. We find that the cumulative returns of U.S. firms are significantly more positive than the returns of non-U.S. firms around the relevant dates. We thus conclude that investors expect the average U.S. firm to experience net benefits related to the new WB provisions, not merely the subset of firms most affected by the new rules.

As this is, to our knowledge, the first empirical evidence on the expected costs and benefits of the Dodd-Frank WB provisions, our findings make several contributions to the literature. First, our study informs the current debate over whether the new regulations are likely to achieve their intended objectives. Our results indicate that investors expect to receive net benefits from the new rules, consistent with the SEC's intentions. These findings should be of practical interest to a broad set of stakeholders, including regulators, legislators, shareholders, managers, employees, and auditors, and extend the literature on the economic consequences of financial regulation.³ Second, we contribute to the developing literature on whistleblowing. Despite the fact that whistleblowers often play a key role in bringing corporate fraud to light (e.g., Dyck et al. 2010) and that whistleblowing events have significant negative consequences for firms (e.g., Bowen et al. 2010), there is no extant research examining whether managers or shareholders view WB provisions as value-enhancing. This paper addresses this void in the literature. Third, we contribute from a methodological standpoint to the compliance and business ethics literature. Building on prior research which views the Code of Ethics as an important corporate governance mechanism (Davidson and Stevens 2013), we introduce the first empirical measure of WB program strength to the literature. The development of an effective measure of WB program strength is potentially important as prior research (Zhang 2008; Seifert et al. 2010) and survey data (Ethics Resource Center 2010) indicates that employees are more likely to report misconduct when they are comfortable with internal systems. Last, we extend the lobbying literature in accounting by taking a broader perspective that considers firms' alternative political strategies. In

³ Gao et al. (2013) also examine the impact of Dodd-Frank, but focus on its role in limiting the systemic risk of large financial institutions. They find that large financial institutions experience negative abnormal stock returns and positive abnormal bond returns in response to key events leading to the passage of Dodd-Frank, consistent with the regulation's potential to reduce risk-taking in large banks.

particular, our evidence linking affected firms' public submission of comment letters with both PAC contributions and more traditional lobbying efforts provides a richer study of corporate political activity than has previously been attempted in this literature.

The remainder of the paper is organized as follows. In Section II, we provide background information on whistleblowing provisions and present our main research question. We outline our sample selection process in Section III and summarize and describe the content of the comment letters submitted to the SEC in Section IV. In Section V, we compare the characteristics of lobbying firms to non-lobbying firms. In Section VI, we examine investor reactions around 21 key event dates related to the WB provisions; Section VII concludes. We also present construct validity tests of our WB index in Appendix A and supplemental tests of issue salience in Appendix B.

II. BACKGROUND AND RESEARCH QUESTION

Recent research on employee whistleblowing in the accounting and finance literature has been motivated by the WB provisions included in the Sarbanes-Oxley Act (SOX) of 2002. SOX mandates a number of measures that were intended to deter improper financial reporting practices. For example, Section 301 of SOX requires firms to create independent audit committees, which, among other mandated functions, are charged with establishing procedures for "the receipt, retention and treatment of complaints regarding accounting, internal control or auditing matters" and for "confidential, anonymous submission by employees with concerns regarding questionable accounting or auditing matters." In addition, according to Section 406, all public companies must disclose whether the company has adopted a written Code of Ethics, which should be designed to prevent fraud or other illegal behavior. In particular, the adopted Code of Ethics should promote, among other things, compliance with governmental laws and regulations; prompt *internal* [italics added] reporting of code violations to an appropriate person or person identified within the Code; and accountability for adherence to the Code. SOX Sections 806 and 1107 also provide anti-retaliation protection for WBs, including reinstatement, back pay, legal fees, and even potential criminal penalties that can be levied on those found to have retaliated against a WB.

Motivated by these regulatory changes, Dyck et al. (2010) examine alleged corporate fraud cases of large U.S. firms between 1996 and 2004 and find that fraud detection does not always rely on standard corporate governance actors, such as investors, the SEC, and auditors, but often leans heavily on less traditional players, such as employees, the media, and industry regulators. Notably, employees account for fraud detection in 17% of examined cases, the highest percentage of any single group. In addition, to address claims by skeptics who argue that employee whistleblowers indulge in frivolous or unreliable complaints, Bowen et al. (2010) examine the economic consequences of firms subject to employee allegations of corporate financial misdeeds. They document evidence of significant negative consequences, including negative stock returns around whistleblowing announcements, increased likelihood of future earnings restatements and shareholder lawsuits, and negative future operating and stock return performance. These results suggest that employee whistleblowers play an important role in detecting corporate fraud and provide indirect evidence on the efficacy of SOX as a mechanism to uncover agency issues at publicly traded firms.

The WB provisions proposed under Section 922 of Dodd-Frank, however, differ substantially from those outlined in SOX in several ways.⁴ First, the Dodd-Frank provisions provide monetary incentives to WBs. Under the Dodd-Frank rules, the SEC will pay awards to WBs who voluntarily provide original information about a violation of federal securities law that lead to the successful enforcement of a covered action, with the awards ranging from 10% to 30% of the monetary sanctions obtained. In this regard, the WB provisions under Dodd-Frank are similar to those under the False Claims Act (FCA) of 1863.⁵ However, unlike the FCA, which specifies no minimum claim amount, Dodd-Frank requires that monetary sanctions total at least \$1,000,000. A minimum threshold

⁴ Dodd-Frank also introduced Section 748 (rewards for whistleblowing to the CFTC), Section 1057 (whistleblower protection for financial industry employees), and Section 1079B (amendments to antiretaliation provisions of the False Claims Act.) We focus on Section 922 because this provision relates most directly to reporting of accounting fraud and is the one that allows WBs to report misconduct directly to the SEC, which was by far the most contentious issue surrounding the new rules.

⁵ Under the FCA, which Congress passed in response to rampant fraud during the Civil War, individuals not associated with the U.S. government could file claims against federal contractors, alleging fraud against the government itself, and receive a percentage of any award that the government receives. In 2009 alone, the U.S. Department of Justice recovered more than \$2.4 billion under the FCA, with at least \$360 million paid out to whistleblowers (Kerschberg 2011).

allows for more efficient allocation of the SEC's limited resources by helping to identify the potentially more serious violations of securities laws.⁶

Along with the introduction of monetary incentives, the Dodd-Frank WB provisions also prohibit retaliation by employers against individuals who provide the SEC with information about possible securities violations. Although anti-retaliation protection was also mandated in SOX, the Dodd-Frank provisions expand this protection by lengthening the statute of limitations, doubling back pay, allowing WBs to file retaliation complaints directly in federal court rather than through an administrative process, and suspending mandatory arbitration of retaliation claims. The Dodd-Frank program also provides anti-retaliation protection regardless of whether there is a determination of a violation or whether the WB satisfied all conditions to qualify for a monetary award.⁷

While increased anti-retaliation protection is important, for our purposes the most controversial difference between the WB provisions under SOX versus Dodd-Frank involves the channels through which WBs initially report information regarding potential violations. SOX mandates that misconduct be first reported through the company's internal compliance system, while Dodd-Frank allows WBs to bypass existing systems entirely and report directly to the SEC.⁸ In fashioning the proposed rules, the SEC explicitly recognized that their proposal had the potential to "reduce the effectiveness of a company's existing compliance, legal, audit and similar internal processes for investigating and responding to possible violations of federal securities laws." Further, the SEC (2010, p. 4) states that the proposed rules are intended "not to discourage

⁶ While the inclusion of monetary incentives in the proposed WB provisions is somewhat contentious, prior research suggests that this method of encouraging WBs is effective. In particular, Dyck et al. (2010) report that 41% of fraud cases in the healthcare industry – where monetary incentives under the FCA and qui tam suits are more likely to be available – are brought to light by employees. In contrast, only 14% of fraud cases are detected by employees in other industries. Importantly, they also observe that stronger monetary incentives do not appear to lead to a higher number of frivolous suits.

⁷ The anti-retaliation protection provided under Dodd-Frank has recently met with legal challenges in the federal courts. In July of 2013, the Fifth Circuit court ruled in *Asadi v. G.E. Energy (USA) LLC* that the Dodd-Frank Act's whistleblower protection provision does not apply to whistleblowers who report securities violations internally but only to those who provide such information to the SEC itself (Ensign and Matthews 2013). Sean McKessy, Chief of the Office of the Whistleblower at the SEC, noted that this decision would likely drive more people to report their concerns to the SEC (see http://www.secwhistleblowerblog.com/sec-whistleblower-chief-discusses-recent-legal-developments/).

⁸ External reporting channels are potentially important. Although Cohen et al. (2010) find that auditors perceive internal whistleblowing processes under SOX as being effective, Schultz et al. (1993) note that the hostile U.S. reporting environment often results in employee reluctance to report internally.

whistleblowers who work for companies that have robust compliance programs to first report the violation to appropriate company personnel."

Our primary objective is to evaluate the net costs and benefits associated with the new WB provisions. The SEC expects the new regulation to maximize the submission of high quality tips and promote greater deterrence of securities law violations, resulting in more effective and efficient enforcement by the agency. To the extent that the new provisions perform as intended, shareholders would benefit from the new rules through resolution of any current violations that managers have been unable or unwilling to address. For example, managers are unable to address problems of which they are unaware due to inadequate internal reporting systems. In addition, managers may be unwilling to address current violations if agency problems interfere with proper governance. Shareholders would also benefit from a reduced likelihood that future violations of securities law will occur. New provisions may also encourage managers to make value-increasing improvements to their existing governance structure that agency issues may have prevented. Finally, shareholders may benefit by transferring some of the cost of corporate governance to external authorities; i.e., they benefit from the SEC's creation of a public good.

However, it also possible that the new WB provisions may result in net costs to shareholders. Direct reporting of securities violations to the SEC may lead to public exposure of existing problems that managers are trying to resolve internally, and prior research documents that the revelation of corporate fraud allegations is extremely detrimental to the firm (Bowen et al. 2010). An additional concern is that direct reporting will cause existing problems to persist longer than necessary, both because managers will not be aware of violations and because the SEC may not have adequate resources to investigate potential violations in a timely manner. Further, a bounty program could weaken existing internal compliance systems by encouraging employees to gather information regarding potential violations with a focus on ensuring their award eligibility with the SEC, rather than on helping companies identify, investigate and correct problems internally. The use of financial incentives may also increase the likelihood that frivolous allegations against a company may occur, thereby needlessly consuming firm resources. Finally, firms may have already devoted the optimal amount of resources to their existing compliance systems, and the new WB provisions may encourage initiation of value-decreasing changes to firms' governance structures.

III. SAMPLE SELECTION

To determine whether the new WB provisions are expected to result in net benefits or costs to shareholders, we examine investor responses around events related to the development and implementation of the WB provision. To increase the power of our tests, we focus our analysis on a sample of firms that are most likely to be affected by the regulation. Following prior research (Kelly 1985; Francis 1987; Ndubizu et al. 1993; Dechow et al. 1996; Ettredge et al. 2002; Hochberg et al. 2009; Hodder and Hopkins 2014), we identify firms that lobbied against strict implementation of the proposed rules via comment letter submissions to the SEC as those that are most likely to be affected. This approach will be powerful to the extent that our assumption that lobbying firms are those most affected by the proposed rules is valid. In this section, we discuss the strengths and weaknesses associated with our sample selection process.

Models of corporate political behavior assert that policy or issue salience is a necessary condition for political activity to occur (see Hillman and Hitt 1999; Getz 1997; or Yoffie 1987); i.e., the importance of a political issue to a company is a primary factor that motivates political action. Consistent with this stance, the lobbying literature within accounting assumes that firms that participate in the FASB's or SEC's political process by submitting a comment letter are those most affected by the accounting standard or SEC rule in question (e.g., Kelly 1985; Dechow et al. 1996; Hochberg et al. 2009). Further, the results in these papers document significant differences between the characteristics of lobbying and non-lobbying firms, providing empirical evidence consistent with this assumption.

We follow prior research and assume that firms that lobbied the SEC regarding the proposed WB rules are those most affected by the regulatory change. However, one difference between our study and the prior lobbying literature in accounting is that our sample is comprised primarily of firms that lobby collectively rather than individually.

That is, our sample includes firms that either submit their own individual comment letter to the SEC or co-sign a comment letter submitted by a professional association. We note, however, that one letter submitted on behalf of the Association of Corporate Counsel (ACC) by Susan Hackett, Senior Vice President and General Counsel of ACC, was co-signed by the in-house legal executives of 250 corporations. In email correspondence dated March 18, 2011, Susan Hackett stated that the comment letter was only circulated among the largest firms at this professional association because " it's just not as helpful to have thousands of people sign a letter which clearly means little to them than it is to have a very deliberate group of larger company / sophisticated clients making much more than a knee-jerk response." The co-signers were all responsible for the compliance and reporting functions within their firms. Our final sample is heavily comprised of these firms.⁹

The choice between individual and collective political participation has been extensively examined in the corporate political activity literature. The most obvious distinction between individual and collective political strategy is that individual action loads all costs directly on the participating firm, whereas in collective action, the cost is shared among participants (Hillman and Hitt 1999). In addition, Yoffie (1987) posits that policy salience is expected to be highest for firms that develop an independent political capacity, though salience remains an important determinant of group political action. Thus, our decision to include firms that collectively lobby through co-signing a submission letter is likely to have two effects on our sample. First, collective lobbying is likely to reduce the cost-benefit threshold of participation, thereby increasing the number of firms that actively choose to participate in the political process. Second, firms that collectively lobby the SEC may be less affected by the proposed regulations than firms that choose to lobby individually, which may bias our sample *against* rejection of the null

⁹ Out of our final sample of 188 firms, 156 (83%) were co-signers of the ACC comment letter. The phenomenon of many public companies co-signing a comment letter authored and submitted by a professional association appears to be an infrequent, or at least newsworthy, event – the *Wall Street Journal* reported on December 15, 2010 that 250 companies would co-sign the ACC letter (Eaglesham 2010). This apparently unusual opportunity for public firms to co-sign the ACC letter rather than prepare and submit their own comments may have reduced the number of firms that would have otherwise lobbied the SEC on an individual basis.

hypotheses.¹⁰ In short, this design choice involves trading off the clear advantage of a greatly increased sample size against the disadvantage of a potential reduction in the salience of the proposed WB regulations for our chosen sample of firms. However, we believe that this tradeoff is worthwhile, especially given that the sample of firms that individually submit comment letters would be too small to permit systematic study of this important research question.

Nonetheless, we address the issue of possible reduced salience among sample firms by performing several additional empirical analyses in Appendix B. We find that lobbying firms are more politically connected to Representatives who ultimately voted against the WB rules, were more likely to incur lobby expenditures on Acts related to the Dodd-Frank WB provisions, and were more likely to meet with SEC officials regarding the WB provisions. These findings support our maintained assumption that lobbying firms are more affected by the WB provisions than non-lobbying firms.¹¹

IV. DESCRIPTION OF COMMENT LETTERS

In Table 1, we summarize the comment letters submitted to the SEC in response to the proposed rules for implementing the Dodd-Frank WB provisions. The deadline for comments was December 17, 2010, but letters continued to be submitted after this date. We report the letters by type of entity submitting (corporation, non-investor group, individual, investment advisor / investor group, accountant, lawyer, and other) and by issue. We identify five key issues raised by the submitters in the comment letters and also document overall assessments of the rules, when provided.

¹⁰ For example, co-signers of the ACC letter may simply be frequent lobbyers or close associates of the letter's author. To address this issue we examine the co-signers of a letter submitted by this same organization (the ACC) on another issue, namely to the Financial Accounting Standards Board (FASB) on August 18, 2010, commenting on the FASB Exposure Draft on Disclosure of Loss Contingencies. A cross-check of both letters reveals that only 26% (65 out of 250) of the co-signers of the WB letter also signed the loss contingency letter. This finding helps support our assertion that lobbying firms represent those most affected by the WB rules.

¹¹ While we are able to identify the bills on which firms incurred lobbying expenditures, we are not able to isolate spending on any particular bill. Lobbying expenditure data is provided only in aggregate, and lobbying dollars spent specifically on WB provisions of Dodd-Frank is unavailable. Since the WB issue is only one of dozens of issues lobbied on during 2010, an analysis of general lobbying expenditures would not be not sufficiently powerful to test our research question. We therefore focus our analysis on comment letter submission to the SEC as the vehicle through which corporations attempt to influence regulators.

The SEC received 224 non-duplicate submissions from 520 different entities through January 18, 2011, the cut-off date used for our analysis. The number of entities exceeds the number of submissions because, as described above, our sample selection process includes collective as well as individual corporate lobbying via letter submission. The SEC also received multiple submissions of two form letter petitions; because the identities of these submitters are not provided, we cannot include these observations in our sample but simply comment on them below.

As indicated in Panel A of Table 1, overall support for the proposed provisions was not high. Only 30% of respondents believed the rules will help achieve the SEC's objective of promoting the greater deterrence of securities law violations. Individuals, however, were overwhelmingly in favor of the proposed provisions, with 87% expressing positive views overall. In contrast, corporations were unanimous in their opposition to the new rules, with 100% expressing negative views overall, while the views of investor and non-investor groups and accountants and lawyers were more mixed, with a range of 14% to 67% expressing positive views overall.¹²

However, the most contentious issue of the proposal, and the issue most frequently addressed in the comment letters, is that WBs *are not required* to first report misconduct through company internal compliance systems before reporting to the SEC. As shown in Panel B of Table 1, 461 respondents directly commented on this aspect of the proposal, with opinion sharply divided between individual and corporate lobbyers. Individuals strongly supported the proposal as written, with 99% (75 out of 76) expressing positive views on this aspect of the provisions. The SEC also received over 800 form letters, stating: "Whistleblowers should never be forced or encouraged to take their concerns to their potentially corrupt bosses first."

Notably, corporate responders unanimously disapproved of the proposal, with all 283 commenters expressing a negative view. These responders argued that the new rules would undermine existing internal compliance programs. For example, Susan Hackett of the ACC wrote that failure to require the use of internal compliance programs would have

¹² The assessments of individuals and the investment advisor/investor group appear to contradict one another. However, a closer inspection of the investment advisor/investor group reveals that the majority of respondents belonging to this group are co-signers of the ACC letter. Thus, it is not clear whether these respondents were commenting as corporations or investors.

unintended results: "...first, by undermining internal compliance and reporting systems that allow responsible companies to comply with critical regulations and conduct themselves in an ethical manner; and second, by proposing an alternative system which fails to replace existing corporate reporting systems with any effective mechanism to ensure that companies obtain early warnings of burgeoning failures or frauds within their organizations."

In addition, corporate respondents also strongly opposed three related aspects of the proposed reporting requirements, also shown in Panel B. First, they were unanimous in their view that eligibility for monetary rewards under the bounty program be made contingent upon reporting through a company internal compliance program to ensure that the new incentives would not discourage employees from using existing systems to report complaints. For example in arguing that internal reporting should be required, five corporations wrote in a joint letter, "Any whistleblower bounty program creates the potential for monetary incentives to cause employees to bypass or ignore internal compliance reporting mechanisms for the possibility of a substantial financial reward." Second, they unanimously opposed the idea that the SEC would not be required to disclose WB allegations to the firm in question. Third, under the proposed rules, WBs who first report violations internally are credited with this date for purposes of eligibility for a monetary award, but only if the WB submits the information to the SEC within 90 days of making the internal report. The choice of a 90-day window was unanimously rejected as too short a time period to allow corporations to conduct internal investigations that would allow them either to resolve the issue or to decide to self-report to the SEC.

Another significant aspect of the SEC program is that WBs are offered financial incentives through a "bounty program" designed to encourage those with knowledge of violations to report this information to the SEC. Few respondents commented on the payment of an award itself since this was not under the discretion of the SEC but had been previously mandated by Congress.¹³ Instead, input was invited on issues concerning

¹³ Section 21F, paragraph (b) of the Dodd-Frank act stipulates, "In any covered judicial or administrative action, or related action, the Commission, under regulations prescribed by the Commission and subject to subsection (c), shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action, in an aggregate amount equal to—

eligibility, such as whether a whistleblower should be *required* to report internally to be eligible (see Panel B), or whether a whistleblower could be paid an award on monetary sanctions based on their own misconduct. As summarized in Panel C of Table 1, respondents were generally supportive of the bounty program, with 15 of 23 comments supporting the payment of awards. On the other hand, allowing culpable WBs to receive some reward in certain circumstances was strongly opposed. Most letters echo the concerns voiced by SEC Commissioner Luis A. Aguilar at the open meeting announcing the proposed rules that, "It seems odd that a program to deter and ferret out wrongdoing may pay financial incentives to those doing the wrong."¹⁴

The proposal also specifies enhanced protection to WBs. Unlike the provisions under SOX, this proposal provides protection to the WB from retaliation regardless of whether there is a determination of a violation or whether the WB satisfies all conditions to quality for an award. As summarized in Panel D of Table 1, of the 401 responses to this issue, 97% were supportive of the broader retaliation protection of the WB, and this support was largely evidenced across all submitter types.

While the proposal enhances the rewards to WB and the protection provided to WBs, it also sets limits to those rewards and that protection. In particular, the provisions do not provide amnesty to individuals who provide information to the SEC and do not preclude the SEC from bringing an action against the WB based on their conduct in connection with reported violations. As reported in Panel E of Table 1, 97% of respondents were supportive of this provision of no amnesty. To prevent unintended consequences, the proposal specifically excludes certain parties from being eligible for WB awards. These parties include: attorneys who obtain information through attorney-client privilege, independent public accountants who obtain information through performance of an engagement, and those who learn about violations through a company's internal compliance, legal, audit or similar function, unless the company did not provide the information to the Commission within a reasonable time or acted in bad faith. Support for these kinds of limitations was high, with 97% of respondents supporting the provisions,

⁽A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions; and

⁽B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions."

¹⁴ Statement of Commissioner Luis A. Aguilar, SEC Open Meeting (Nov. 3, 2010).

with support across all categories of respondents. Lastly, as shown in Panel F, a single responder viewed the process for filing a complaint as reasonable, and no responder agreed that the rules were sufficiently clear and understandable.

While corporations provided detailed comments on almost all elements of the proposal, individuals' comments were noticeably concentrated on a few issues. In addition to expressing overall support for the provisions and no requirement to report internally, most individuals commented on the extended retaliation protection, with 95% expressing support. With the exception of these three issues, individuals were largely silent on the remaining elements of the proposal. Individuals appear to have been content expressing support for the most significant elements of the proposal, leaving the SEC to work through the remaining details on its own.

In summary, responses to the SEC proposal were mixed. The introduction of monetary incentives and improvements in anti-retaliation protection of WBs were generally supported across all constituent types. However, on the issue of WBs reporting violations directly to the SEC rather than through internal channels, opinion was sharply divided between individual and corporate respondents, with corporate lobbyers expressing unanimous disapproval.

V. CHARACTERISTICS OF LOBBYING VERSUS NON-LOBBYING FIRMS

As discussed in Section III, we assume that firms that comment on the proposed provisions represent those most likely to be affected and provide additional empirical tests in Appendix B to help validate this assumption. To gain insight into the underlying motives of the firms most opposed to the new provisions, as a preliminary analysis we empirically compare the firm characteristics of lobbying versus non-lobbying firms. We focus on characteristics that represent potential sources of the costs and benefits of the new rules, drawing from different views expressed during the public comment period. Because the new provisions are intended to improve upon firms' internal governance practices, we are especially interested in examining the strength of firms' existing WB programs and the degree of agency conflict within the lobbying firms. We also examine whether lobbying firms are more vulnerable to WB allegations than other firms, since the consequences of WB allegations are quite negative (e.g., Bowen et al.

2010), and managers may be concerned about allegations being reported directly to the SEC after the WB provisions take effect. Understanding differences between lobbying and non-lobbying firms also helps us in interpreting investor reactions around key WB event dates in Section VI.

We employ a one-to-one matched sample design to compare characteristics of lobbying and non-lobbying firms. We match based on industry and size as both the political science and accounting literatures (Hill et al. 2011; Hillman et al. 2004; Hodder and Hopkins 2014; Hochberg et al. 2009) identify these as key determinants of lobbying. Size, in particular, is the single most important determinant of political activity and of lobbying efforts. In addition, the comment letter submitted by the ACC that was co-signed by a majority of our sample firms was only circulated among the largest firms at this professional association; we therefore wanted to obtain the closest match possible on firm size to help mitigate selection bias. We control for industry effects by first limiting the set of possible matches to firms within the same two-digit SIC code. We eliminate potential matches with total assets at the end of fiscal 2009 that are less than 50% or greater than 200% of the sample firm's total assets and choose the closest size match from the remaining firms. If no two-digit match exists, then one-digit matches are used.¹⁵

After eliminating private and foreign firms from the 283 corporations that submitted comments to the SEC, 218 publicly-traded corporations remain in the sample. Missing Compustat, CRSP, or proxy statement data further reduce the sample size to 209, and we are unable to find size and industry matches for 21 firms. However, the resulting final sample, consisting of 188 pairs of lobbying firms and their non-lobbying controls, is very closely matched on size – mean log of total assets is 8.132 for the lobbying firms versus 8.109 for the non-lobbying group, with no significant difference (p-value = 0.9149). In addition, relative to the population of Compustat firms, a significantly greater (lower) proportion of lobbying firms operate in the communication, manufacturing, transportation, and retail (financial) sectors, consistent with our maintained assumption that industry membership is a significant determinant of lobbying.

¹⁵ Our objective is to describe lobbying behavior, and matching on dimensions that may be potential determinants would defeat the purpose of the analysis. We thus limit our matching variables to industry and size and include all other potential determinants as independent variables.

To better understand the characteristics of the lobbying firms, we estimate a probit regression of the indicator variable *LOBBY*, which equals one (zero) for lobbying (non-lobbying) firms, on measures of WB program strength, agency conflict, and vulnerability to WB allegations. All independent variables are measured as of the end of fiscal 2009, except as indicated below.

Variable Measurement

Measuring WB Program Strength

To measure the strength of firms' existing WB programs, we construct a firm-level index of WB program strength based on descriptions of the program provided within each firm's Code of Ethics in effect at the time of the lobbying. We obtained these Codes from the firm's 10-K or proxy filing or from its website.¹⁶ To help ensure the content validity of our measure, we rely on the ICC Guidelines on Whistleblowing to develop our measure (ICC 2008). The Guidelines provide recommendations to serve as a point of reference for firms wishing to establish strong WB programs. We rate WB programs on three broad categories and ten sub-categories based on these Guidelines.¹⁷

First, we look at program efficacy to capture the importance placed on employee reporting of accounting and auditing fraud. We rate firms on two dimensions: (1) commitment required of employees and (2) firm responsiveness. For the first dimension, a firm scores a 2 if the Code explicitly states that it requires reporting of possible Code violations and specifies disciplinary action for failing to report, 1 if it requires reporting but does not specify disciplinary action, and 0 if it does not require reporting. For the second dimension, a firm scores a 1 if it indicates it will follow-up on reports and 0 if it does not. The maximum score for program efficacy (WB_PE) is 3.

¹⁶ We were unable to obtain the Code of Ethics for five of our control firms. Because we were concerned about introducing sampling bias into the analysis, we chose to retain these firms rather than identify replacement controls. We code each of these firms as having an index of WB program strength of zero, which biases us *against* finding that lobbying firms have weaker WB programs than non-lobbying firms.

¹⁷ Two of the authors conducted the coding. By comparing mean scores across all 10 sub-categories, we ensured consistency in coding. Whenever judgment was required, all three authors discussed the issue and came to a consensus. We verified our coding by recoding for a random selection of firms. We also printed out the codes for all firms and documented the evidence we used to arrive at a score for each sub-category to ensure that all decisions were documented and substantiated.

Second, we look at the extent to which the established WB channels are independent of management. We rate firms on four dimensions: (1) reporting line choice, (2) highest party of the reporting line, (3) reporting line emphasis, and (4) contact information availability. A firm scores a 1 if it provides the WB the option of reporting to different parties and 0 if it does not. For the second dimension, we rate firms based on the nature (internal, quasi-external, external) and independence from management of the highest reporting line. A firm scores a 4 if the highest reporting line is external/ independent (audit committee, independent board member, third-party hotline reporting to audit committee), 3 if it is quasi-external/independent (internal audit or compliance group reporting to audit committee), 2 if it is external/non-independent (third-party hotline reporting to management), 1 if it is quasi-external/non-independent (internal audit or compliance group reporting to management), and 0 if it is internal/non-independent (supervisor, CEO, company-managed hotline). For the third dimension, a firm scores a 2 if it emphasizes the highest reporting line, 1 if does not emphasize any reporting line, and 0 if it emphasizes internal/non-independent reporting lines. Finally, a firm scores a 1 if it provides contact information for the highest reporting line and 0 if it does not. The maximum score for independence of reporting (WB IR) is 8.

Third, we look at the protection provided to WBs. We rate firms on four dimensions: (1) anonymity; (2) confidentiality; (3) feedback; and (4) retaliation protection. A firm scores 1 on the anonymity dimension if it allows anonymous reporting and 0 if it does not. For confidentiality, a firm scores a 2 if it protects the identity of the WB after he/she reports, 1 if it restricts this protection, and 0 if it does not mention confidentiality. A firm scores a 2 on feedback if it specifies that it will initiate feedback on the status of reports, 1 if it provides the WB the option to initiate feedback, and 0 if it does not mention an opportunity for feedback. For protection of the WB against retaliation, a firm scores a 2 if it prohibits retaliation and specifies disciplinary action for retaliators, 1 if it prohibits retaliation. The maximum score for protection of WBs (WB_PROT) is 7.

Our aggregate whistleblowing program strength measure is computed as the sum of the three categories, with a maximum total score (*WB_TOT*) of 18. Our coding scheme assigns higher weight to the independence of reporting and WB protection measures to

reflect the issues of concern to stakeholders as described in the comment letters. However, we also employ an index that is equally-weighted across the three dimensions in our sensitivity tests.¹⁸

We assess the construct validity of our index of WB program strength by comparing our score to other corporate compliance measures that we obtained from the Ethisphere Institute, the Society of Corporate Compliance and Ethics (SCCE), and the U.S. Department of Justice (DOJ). Our measure of WB program strength correlates in a predictable manner with these independent measures of corporate compliance, indicating that our index has good external construct validity. We describe these tests in detail in Appendix A.

Measuring Agency Conflict

To measure the degree of potential agency conflict, we focus on measures that we believe best capture the ease with which managers can exercise their own preferences as opposed to those of outside shareholders. Our main variable to proxy for this effect is Bebchuk et al.'s [2009] entrenchment index (*E-INDEX*), which is based on six corporate governance provisions: staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments. An indicator variable is created for the existence of each provision, and *E-INDEX* equals the sum of the six variables; *E-INDEX* thus ranges from zero to six. Bebchuk et al. [2009] find that increases in this index are monotonically associated with economically significant reductions in firm valuation, while the other 18 provisions followed by the Investor Responsibility Research Center (IRRC) and included in the Gompers, Ishii, and Metrick (2003) governance index are uncorrelated with firm valuation and returns. We obtain data to calculate *E-INDEX* for fiscal 2009 from SharkRepellent.net.

Two additional variables are employed as proxies for potential agency conflict. We include CEO duality (CEO=COB), as prior research argues that agency costs increase with CEO duality since the board's ability to monitor the CEO is reduced (Fama and

¹⁸ For our equally-weighted measure, we standardize the individual WB program strength measures to have a mean of 0 and a standard deviation of 1 by subtracting the mean from each variable and dividing by its standard deviation. The equally-weighted WB program strength measure, *SWB_TOT*, is calculated as the sum of the three standardized components.

Jensen 1983). Consistent with this argument, research has found that firms that combine CEO and Chairman of the Board positions tend to perform more negatively than firms that separate the two roles (e.g., Boyd 1995; Balsam and Upadhyay 2009; Bebchuk et al. 2009). We also include managerial stock ownership (*MGTOWN*) because greater levels of managerial ownership should reduce the conflict of interest between managers and outside shareholders (Jensen and Meckling 1976). We measure managerial ownership (*MGTOWN*) as percentage of stock owned by the top five executives, and obtain CEO=COB and *MGTOWN* from firms' 2009 proxy statements filed with the SEC.

Measuring Vulnerability to WB Allegations.

Our comparison also includes variables that are intended to capture firms' vulnerability to WB allegations and other factors that may influence the lobbying decision. Given the negative consequences of WB allegations, managers of firms that are particularly vulnerable to an allegation may lobby against the proposed provisions either because they wish to protect shareholders from the negative consequences of allegations, or because such allegations diminish their own ability to consume firm resources.

Because firms with poor financial reporting quality may be more vulnerable to WB allegations, we include Section 302 internal control weaknesses (*ICW*), restatements (*RESTATE*) and idiosyncratic stock return volatility (*IDIOSYN*) as proxies for reporting quality in our analysis. Doyle et al. (2007) and Lu et al. (2011) document that accruals quality is negatively associated with internal control weakness disclosures, and Costello and Wittenberg-Moerman (2011) assert that in contrast to accruals quality, internal control weaknesses disclosures provide a more comprehensive measure of reporting quality. Wilson (2008) finds that perceived reporting quality decreases for restatement firms following restatement announcements, and Hutton et al. (2009) document that idiosyncratic stock return volatility is negatively associated with earnings opacity and crash risk.¹⁹ We define *ICW* as an indicator variable that equals one if the firm disclosed an internal control weakness in any quarter of fiscal 2005 through 2009, and zero

¹⁹ Because we include a number of financial firms (12% of the sample), we are unable to use accrual measures of financial reporting quality for the full sample. We thus rely on reporting quality proxies that have been shown to be correlated with traditional accrual measures and can be empirically estimated for all firms. We conduct additional tests using an accrual measure excluding financial firms, as discussed in this section.

otherwise. Similarly, we define *RESTATE* as an indicator variable that equals one if the firms' financial statements contained a misstatement during fiscal 2005 through 2009, and zero otherwise. We follow prior research and estimate *IDIOSYN* for fiscal 2009 using firm-specific regressions of weekly stock returns on lagged and current market and industry returns. *IDIOSYN* is defined as the log transformation of the ratio $(1-R^2)/R^2$, where R^2 is the coefficient of determination from each firms' regression estimation. We obtain internal control weakness data and restatements from Audit Analytics and stock return data from CRSP.

As an alternative to *IDIOSYN*, we also consider discretionary accruals as a measure of reporting quality. Bowen et al. (2010) find that firms facing greater capital market pressure, including higher potential earnings management, are more vulnerable to whistleblowing allegations. We measure absolute value of discretionary accruals (*ABSDACC*) based on the Jones (1991) model for fiscal 2009. Consistent with previous work, we exclude financial institutions (SIC codes 6000 through 6999) for the analysis using *ABSDACC*. We obtain accruals model data from Compustat.

Firms that have been involved in WB cases in the past may also be more vulnerable to future WB allegations. As in Bowen et al. (2010), we consider both a press sample and an Occupational Safety and Health Administration (OSHA) sample of firms subject to WB allegations. The OSHA sample represents the number of complaints filed by WB's over 2007-2009 for retaliation under SOX after voicing allegations of financial impropriety. The press sample consists of events drawn from a Gale Group National Newspaper Index search of every combination of the following two groups of search terms: (1) "whistle," "whistle- blowing," "whistleblower," "whistle-blower," and (2) "financial," "accounting," "reporting," "fraud," "accounting fraud" over the 2007-2009 period. The two subsamples are mutually exclusive in that the OSHA cases relate specifically to retaliation allegations under SOX whereas press cases relate to a broader set of allegations, including those under the False Claims Act and other federal whistleblower statutes. Our combined measure, #*WB_ALLEG*, captures the number of times a firm has been named in a WB complaint by OSHA or the press, over the 2007-2009 period.

External monitoring may reduce the likelihood that firms will be the target of WB allegations, as managers may be less likely to engage in financial misconduct if external monitoring is strong. We include *BLOCKOWN*, defined as the percentage of stock owned by blockholders, measured at the end of 2009 based on reported blockholdings obtained from firms' proxy statements. Last, Bowen et al. (2010) find that growth firms are more likely to be targets of WB allegations. We therefore include firms' book-to-market (*BTM*) ratio as a proxy for growth. We define *BTM* as Compustat annual book value per share divided by price per share as of end of fiscal 2009.

Our final model is provided below (firm subscripts are suppressed). The first four variables control for the general determinants of lobbying identified in the previous literature (Hill et al. 2011; Hochberg et al. 2009; Ndubizu et al. 1993; Francis 1987). Lobbying firms generally have lower leverage, higher free cash flow, are more profitable, and are older.²⁰ Leverage (*LEV*) is defined as long-term debt divided by total assets. Free cash flow (*FCF*) is operating cash flow less capital expenditures divided by total assets. Return-on-assets (*ROA*) is defined as income before extraordinary items divided by total assets are measured at the end of 2009. To control for outliers, we winsorize all continuous variables at 1% and 99%. The final model is as follows:

 $Pr(LOBBY) = \alpha_0 + \alpha_1 LEV + \alpha_2 FCF + \alpha_3 ROA + \alpha_4 AGE + \alpha_5 WB_TOT + \alpha_6 E_INDEX$ $+ \alpha_7 CEO + COB + \alpha_8 MGTOWN + \alpha_9 ICW + \alpha_{10} RESTATE + \alpha_{11} IDIOSYN$ $+ \alpha_{12} ABSDACC + \alpha_{13} \#_WB_ALLEG + \alpha_{14} BLOCKOWN + \alpha_{15} BTM + \varepsilon$ (1)

Univariate Comparisons of Lobbying and Non-Lobbying Firms

In Panel A of Table 2, we present details of our coding of WB strength measures, including results for the three broad categories and ten sub-categories of the *WB_TOT* measure. We document highly significant differences in the strength of firms' existing WB programs under SOX, with lobbying firms exhibiting significantly weaker programs than non-lobbying firms. Mean (median) *WB_TOT*, our measure of the overall program strength, is 9.101 (9.0) for the lobbying firms versus 10.846 (11.0) for the non-lobbying

²⁰ Previous literature finds that the two most significant determinants of lobbying are firm size and industry membership. By selecting one-to-one matched control firms based on size and industry, we eliminate the need to control for these two variables.

firms; both differences are significant at p=0.0001. (The highest score for both groups is 16 relative to a possible maximum of 18.) We document similar findings for each of the three separate components of our WB program index. Mean (median) program efficacy, or WB PE, which measures the importance placed within a firm's Code of Ethics on employee reporting of fraud and misconduct, is 1.638 (2.0) for lobbying firms versus 1.931 (2.0) for non-lobbying firms relative to a maximum score of 3; p-values for differences are 0.0009 and 0.0006 for means and medians, respectively. Lobbying firms are significantly weaker on both elements of our program efficacy measure - reporting by employees is less likely to be mandatory, and firms are less likely to commit to following up on reports. Lobbying firms also exhibit significantly weaker independence of reporting within their WB programs. Our measure of independence, WB IR, is 4.362 (4.0) for lobbying firms versus 5.447 (6.0) for non-lobbying firms relative to a maximum score of 8, with both differences significant at p=0.0001. Three of the four elements of independence are weaker for lobbying firms: the nature and independence of the highest reporting line, the extent to which the highest reporting line is emphasized, and whether the firm provides contact information for the highest reporting line. It is interesting to note that the median score for the highest party of the reporting line is 2 for lobbying firms, suggesting that the typical lobbying firm utilizes a third-party hotline that reports to management, not to an external (quasi-external) party like the board (internal audit). Lobbying and non-lobbying firms do not appear to differ on whether there is an option to report to different parties. Finally, mean (median) WB PROT, which measures the protection offered to WBs is 3.101 (3.0) for lobbying firms versus 3.468 (4.0) for nonlobbying firms relative to a maximum score of 7, with both differences again highly significant. Lobbying firms are less likely to allow anonymity in reporting or protect the confidentiality of the WB once they have reported, but are similar to non-lobbying firms in the providing both feedback and protection from retaliation. The scores for providing feedback to the WB are low for both lobbying and non-lobbying firms, suggesting that most firms do not offer to provide any feedback to the WB after an irregularity has been reported.

Univariate differences between lobbying and non-lobbying firms for all variables included in equation (1) are reported in Panel B on Table 2. We find that lobbying firms

have significantly more entrenched managers than non-lobbying firms. Mean (median) *E-INDEX* is 2.782 (3.0) for lobbying firms versus 2.160 (2.0) for non-lobbying firms; p-values are 0.0001 and 0.0002 for differences in means and medians, respectively. Lobbying firms also are significantly more likely to have CEOs that serve in dual roles as Chairman of the Board – mean *CEO=COB* is 0.590 for lobbying firms versus 0.479 for non-lobbying firms (p-value=0.0299). However, we find no difference in managerial ownership across the two groups – mean (median) *MGTOWN* is 0.093 (0.030) for lobbying firms versus 0.105 (0.041) for non-lobbying firms. Regarding the control variables in Panel B of Table 2, only one difference is significant; lobbying firms are more likely to have been named in a WB complaint with OSHA or in the press over the 2007-2009 period (p-value of 0.0908 and 0.0912).

In Panel C of Table 2, we present Pearson correlation coefficients between the independent variables with significance levels in parentheses. The sample size is 376 for all pair-wise correlations except for those involving the variable *ABSDACC*. Here, financial firms (SIC codes 6000 through 6999) are excluded and the sample size is 328. The correlations and significance levels for *ABSDACC* are indicated in italics.

The highest correlations are between WB_TOT and its three subscores WB_PE , WB_IR , and WB_PROT . Of greater interest, however, are the correlations among the three subscores. These are all highly significant (at p=0.0001) and positive, which gives some assurance regarding the internal consistency of WB_TOT .²¹ In addition, all four WB program strength measures are significantly positively correlated with *LEV*, and three of the four are significantly negatively correlated with *BTM*, which indicates that highly levered and high growth firms tend to have stronger WB programs in place. WB_PE is negatively correlated with both *RESTATE* ($\sigma = -0.1189$, p=0.0211) and with *ABSDACC* for the reduced sample excluding financial firms ($\sigma = -0.0985$, p=0.0750), which suggests that firms with strong WB program efficacy experience fewer restatements and exhibit less earnings management.

Three correlations are quite high: *FCF* and *ROA* are positively correlated (correlation coefficient of 0.5536, p=0.0001); *ROA* and *IDIOSYN* are positively correlated (correlation coefficient of 0.4180, p=0.0001); and, *ICW* and *RESTATE* are positively

²¹ More formal construct validity tests of our WB program strength index are presented in Appendix A.

correlated (correlation coefficient of 0.4211, p=0.0001) indicating that firms with internal control weaknesses are also more likely to experience a restatement. Idiosyncratic risk (*IDIOSYN*) is also significantly correlated with a number of variables. We note, however, that multicollinearity does not appear to be a problem for our tests.²²

Multivariate Results - Lobbying versus Non-Lobbying Firms

In Table 3, we report results from our estimation of equation (1), presenting six alternative specifications. Column (1) includes only general lobbying variables from the previous literature, columns (2) and (3) add our key variables of interest, WB program strength and managerial entrenchment, and columns (4) through (6) present the full model including additional variables to capture vulnerability to WB allegations. The first five specifications are based on the entire sample of lobby and non-lobby firms (N=376); specification (6) includes only non-financial firms with data available to compute *ABSDACC* (N=328).

In column (1), none of the general lobbying variables are significant at conventional levels and explanatory power of the model is low (pseudo R² is 1.0%). This is likely due to the fact that we exclude the two most significant determinants of lobbying from the model – firm size and industry membership – since we employ a one-to-one matching design based on size and two-digit industry code. Therefore the explanatory power of our models is understated relative to models that employ broader samples and include these two key variables. However, when we include our variables of interest, explanatory power improves significantly with pseudo R² increasing to 14.8% and 16.5% in columns (2) and (3) respectively. Here the findings are consistent with those reported in the univariate tests. First, we document a very strong negative association between the decision to lobby again the proposed WB provisions and the strength of firms' existing WB programs. The estimated coefficient on *WB_TOT*, our overall index of WB program strength, is -0.1275 with a p-value of 0.0001.²³ When we replace *WB_TOT* with its three

²² For multivariate tests, we compute condition indexes to formally assess collinearity. Weak dependencies are associated with condition indexes of 5-10; moderate to strong dependencies have condition indexes of 30-100 (Belsey et al. 1980). The highest condition number for the models reported in Table 3 is 27, suggesting that collinearity is not a significant problem in our reported results.

²³ Because the maximum possible scores of WB_PE, WB_IR, and WB_PROT are not identical, we implicitly assign different weights to each component when summing them together to obtain the total

subscores, *WB_PE*, *WB_IR*, and *WB_PROT*, in column (3), we find that the estimated coefficients on WB program efficacy (*WB_PE*) and WB independence of reporting (*WB_IR*) are both negative and significant (p-values of 0.0130, 0.0001, respectively) while the estimated coefficient on *WB_PROT*, which measures the strength of antiretaliation protection for WBs, is not significantly different from zero. In letters to the SEC, lobbying firms argue that they have effective internal compliance systems in place that provide senior executives and boards an early warnings system for potential fraud, and that these systems would be undermined by the new rules. However, our findings suggest that WB programs of lobbying firms are significantly weaker than those of non-lobbying firms, the WB programs of lobbying firms have reduced emphasis on the importance of employee reporting of accounting and auditing fraud, and that the channels of reporting they provide to WBs are less independent than those of non-lobbying firms.

We also find a positive association between managerial entrenchment and the decision to lobby against the proposal - the estimated coefficient on *E-INDEX* is positive across both specifications (p=0.0001 in both). Firms with CEOs who serve in dual roles as Chairman of the Board are also significantly more likely to lobby against the new WB rules – the estimated coefficient on CEO=COB is positive in both specifications, with p-values of 0.0208 and 0.0112. Managerial ownership (*MGTOWN*) does not appear to be a significant determinant of lobbying behavior.

In columns (4) through (6) we include the WB vulnerability measures and pseudo R^2 ranges from 16.6% to 17.7%. Findings for the WB program strength and agency variables hold in these three specifications. Results for the variables that measure vulnerability to whistleblowing are mixed. Two variables have estimated coefficients that are significantly different from zero in the direction predicted. The coefficient for $\#_WB_ALLEG$ is positive and significant at p=0.0719, 0.0421 and 0.0198, and *BTM* is negative and significant in two of the three specifications. *ABSDACC* is approaching but does not reach significance (p=0.1252) in column (6). Results are very

index WB_TOT . As a sensitivity test, we standardize each subscore to have a mean of 0 and a standard deviation of 1.0. We recalculate SWB_TOT so that each of the three subscores is equally weighted; the results reported in columns (2) and (4) in Table 3 are insensitive to this change.

similar for all six models when we do not winsorize, except that AGE becomes significant at the 0.10 level in two of the six specifications.²⁴

Together, these results provide evidence that lobby firms have been involved in more WB cases, and are faster-growing than non-lobby firms. On the other hand, the results for our WB strength and agency conflict variables continue to explain a much greater portion of our results. We interpret these findings as follows: while lobbying firms are somewhat more vulnerable to WB allegations, the main determinants of lobbying via comment letter submissions appear to be related to their weaker WB programs and more severe agency conflicts. These findings provide a context within which to interpret the results of our tests on investor reaction in the following section.

VI. INVESTOR REACTION TO WB PROVISIONS

We evaluate market perceptions of the net costs and benefits of the proposals by examining investor reactions around event dates related to the WB provisions. Positive (negative) shareholder reactions around events that increase (decrease) the likelihood of strict implementation of the proposed provisions would be consistent with their providing net benefits to (imposing net costs upon) investors.

We identify relevant event dates by conducting a comprehensive search of the SEC's website for press releases and congressional testimony related to changes in its handling of whistleblower tips. We also search the legislative history of the U.S. Congress to identify the key events leading to the passage of the Dodd-Frank Reform Act, which encompasses the WB provisions. This process yields 26 separate event dates, spanning the time period from March 2009 to August 2011. For purposes of analysis, we combine events that occur within five days of another into a single event window. We thus obtain

²⁴ In untabulated analysis, we test the possibility that the vulnerability variables become significant conditional on firms having weak WB programs. We include an interaction variable TOP_WB * vulnerability variable. TOP_WB is an indicator variable that equals 1 for firms where WB_TOT is in the top three quartiles, and zero otherwise. We repeat our analysis for columns (4) through (6) of Table 3.When we include interactions terms, we find that the coefficient for *ICW* is positive and significant at the 0.10 level in two of the three specifications, the coefficient for *RESTATE* is positive and significant at the 0.05 level in two of the three specifications, and the coefficient for *BTM* is negative significant at the 0.05 level in all three specifications; no other vulnerability variables are significant.

21 event windows, which are listed in chronological order and briefly described in Table 4.²⁵

Investor reactions to these events will be a function of the change in the expected probability that the regulation will be adopted and its expected impact on shareholder value. *Ex ante*, it is difficult to predict whether investors will view any individual event as informative; indeed, the unobservability of investor's expectations is a fundamental limitation of all event studies (Leftwich 1981). We thus take a conservative approach and include all events specifically related to the new WB provisions. This design choice helps to ensure that we do not omit any relevant events, though at the cost of introducing noise through inclusion of irrelevant ones. In addition, unless the news conveyed to the public clearly refers to a reduction in the likelihood of adoption or in the strictness of implementation, we assume each event increases or maintains the likelihood of adoption.²⁶

The first event specifically related to the development of the SEC's new WB provisions occurs on March 26, 2009, when SEC Chair Mary Schapiro testifies before the U.S. Senate Committee on Banking, Housing, and Urban Affairs concerning enhancing investor protection and regulation of securities markets. In her testimony, Chair Schapiro anticipates making "a request for authority to compensate whistleblowers who bring us well-documented evidence of fraudulent activity." As this is the first mention of offering monetary rewards to WBs, we view this testimony as a key event that increases the likelihood that new WB provisions will be adopted.

SEC officials testified to U.S. Senate and House committees regarding the development and implementation of the new WB program on numerous additional occasions throughout 2009-2011, including Events 2-7, 10-12, 15-17, and 21. With one exception (Event 21) that occurs after the final WB rules were adopted on May 25, 2011, we view each instance of public testimony as increasing or maintaining the likelihood that the provisions will are adopted, as congressional scholars report that committee hearings significantly affect legislative outcomes (Oleszek 2007).

²⁵ We also search Factiva for financial press articles related to the new WB provisions. However, each of the published articles we identified relate to a SEC or legislative event already listed in Table 4; we therefore do not include the publication of financial press articles as separate "events" in our analysis.

²⁶ We perform sensitivity tests related to this assumption later in this section.

As shown on Table 4, we also include key legislative events directly related to the Dodd-Frank Act, beginning on July 10, 2009 with its original proposal as the Investor Protection Act of 2009 (Event 3). The legislation, later renamed as the Dodd-Frank Reform Act, passed the House and Senate on December 11, 2009 (Event 6) and May 20, 2010 (Event 8), respectively. The combined legislation passed the House and Senate in early summer of 2010 and was signed into law on July 21, 2010 (Events 9 and 10). We view each of these events as increasing or maintaining the likelihood that the WB provisions will be adopted.

Finally, we include events directly associated with the specifics of the WB provisions. On November 3, 2010, SEC Commissioner Luis A. Aguilar made a speech announcing the WB program and inviting public comment on the detailed rules to implement the Dodd-Frank WB requirements (Event 13). We view the release of the proposed rules as increasing or maintaining the likelihood of adoption, though it is unclear how much new information this event revealed to market participants, as the broad parameters of the WB program were already known upon enactment of Dodd-Frank. In addition, a Wall Street Journal article published on November 4, 2010 ("SEC Proposed Rules for Bounty Program") stated that the proposed rules "aimed to ease some concerns among companies about a new bounty program" by encouraging WBs to also report internally.²⁷ We address the ambiguity associated with this event in our sensitivity tests.

Event 14 is the date on which firms submitted comment letters to the SEC. Although this date ranges from December 3 to December 17, 2010, the vast majority of firms submit letters on December 15, 2010, the last day of the public comment period. We expect this event to be important to investors because firms that lobby individually or collectively via comment letter submissions publicly reveal that they are likely to be significantly affected by the new WB rules; we thus view this event as positively related to the economic impact of the proposed rules on the lobbying firm. However, if investors are able to perfectly predict which firms are likely to lobby against the WB provisions, then lobbying efforts should not reveal new information to the market, which will

²⁷ In an entry on the WSJ Law Blog, one of the co-authors of this article, Ashby Jones, further discussed the proposed rules, stating, "Neither side is thrilled." (See <u>http://blogs.wsj.com/law/2010/11/04/sec-issues-proposed-whistleblower-rules-the-lobbying-continues/?KEYWORDS=sec.</u>)

attenuate investor responses around Event 14. In addition, an alternative interpretation is that investors view lobbying efforts against the proposed rules as negatively affecting the likelihood of their strict implementation. We address this possible interpretation in later tests.

Event 18 occurred on May 11, 2011, when Congressman Michael Grimm introduced draft legislation, "The Whistleblower Improvement Act of 2011" (H.R. 2483), that challenged the proposed WB provisions and argued for preserving the primacy of a company's internal reporting system as the channel for reporting misconduct. Specifically, the bill proposed to deny any award granted under the WB program to employees who failed to *first* report information to their employers before reporting such information to the SEC. We view this event as decreasing the likelihood that WB provisions would be adopted and strictly implemented.

The final WB rules were adopted on May 25, 2011 (Event 19), with minor modifications that allow the SEC to increase financial awards if a WB first reports violations internally. Because the provisions were otherwise adopted as proposed, we view this event as an overall affirmation of the provisions as proposed. We also note that the final adoption of the rules was not a foregone conclusion, given that as of July, 2014, only half of the total required rulemakings under Dodd-Frank have been finalized, and one quarter have not vet been proposed.²⁸ However, we address the possibility that investors view the modifications to the rules as negatively associated with rule implementation in our sensitivity tests.

On July 11, 2011 (Event 20), the Whistleblower Improvement Act of 2011, which would require WBs to first report information related to misconduct internally before going to the SEC, was formally introduced to the House. Because this proposed legislation would undo the effects of the Dodd-Frank WB provisions, we view this event as decreasing the likelihood of their implementation.²⁹ Finally, on July 21, 2011, SEC Chair Shapiro testified to the Senate Banking Committee regarding the decision to take a WBs use of a firm's internal program into account when determining awards. Because

 ²⁸ See http://www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report.
 ²⁹ This legislation died in committee during the 112th Congress and was never enacted.

this announcement highlights the modification of the original rules, we view this event as negatively associated with implementation of the proposed rules.

We examine market reactions around the 21 events using the Schipper and Thompson (1983) event study methodology, which controls for potential cross-sectional correlation in residuals due to the alignment of event dates for all affected firms. We estimate the following regression for our sample of lobbying firms:

$$\tilde{R}_{pt} = \alpha_p + \beta_p \tilde{R}_{mt} + \sum_{k=1}^{K} \gamma_{pt} D_{kt} + \tilde{\varepsilon}_{pt}$$
⁽²⁾

where \tilde{R}_{pt} is the return on portfolio p on day t; \tilde{R}_{mt} is the CRSP value-weighted return on day t; α_p and β_p are market model parameter estimates; D_{kt} is an indicator variable that equals one during the five-day window (-1, +3) around event k and zero otherwise; γ_{pk} is the estimated mean effect of event k for portfolio p; and $\tilde{\varepsilon}_{pt}$ is an error term. Following previous research on market reactions to regulatory events, we use a five-day window that allows for alternative modes of dissemination of information across our event dates (speeches, SEC and congressional news releases, newspaper articles, etc.) and ensures that we adequately capture investor reaction to each event.³⁰ Day t runs from March 1, 2009 to July 31, 2011.

Results are presented in Table 4. We first present results for the portfolio of 182 lobbying firms.³¹ Most notable is the investor reaction around Event 1, which is the date that the SEC Chair first announced an intention to compensate WBs for tips leading to successful prosecution of securities violations. The mean excess portfolio return around this date is positive at 0.0180 and highly significant (p=value=0.0004), indicating that investors expect net benefits to result from this event.

However, because adoption of the new WB rules resulted from a process that evolved over more than a two-year period, we draw our main inferences from the market reactions associated with relevant events taken together, rather than with each individual event (e.g., Zhang 2007; Armstrong et al. 2010). As shown in Table 4, the combined

³⁰ Zhang (2007) varies the length of her event windows in examining market reaction to legislative events pertaining to SOX to consider timing of speeches and related news reports, and Bushee and Leuz (2005) use five-day event windows in considering the economic consequences of regulatory changes mandating increased disclosure for OTCBB firms.

³¹ The sample size drops to 182 firms because we require stock return data for the full estimation period of March 1, 2009 to July 31, 2011.

effect of Events 1-21 (with events 18, 20, and 21 reverse coded to reflect the fact that these events are assumed to decrease the likelihood of strict implementation) is a mean excess return of 0.0268, but is not significant at conventional levels (p=0.1499). However, when we remove the potentially confounding effects of events that are solely related to the passage of Dodd-Frank (Events 8 and 9), the mean excess return of 0.0395 is significantly positive at p=0.0584. When we remove all of the Dodd-Frank legislative events (Events 3, 6, 8, 9, and 10), the mean excess return of 0.0377 is still positive, and the p-value improves to 0.0471. These results are consistent with investors viewing the adoption of the WB rules as providing net benefits to shareholders.

To help ensure that our results are not driven by contemporaneous industry or marketwide news around our event dates, we also estimate excess returns around each event date for the one-to-one matched control sample of non-lobbying firms identified earlier in Section V. As reported in the second column of Table 4, the portfolio of control firms also experience positive mean excess returns around Event 1, suggesting that investors view all firms as benefiting from the possible compensation of WBs. However, when we examine the effects of the combined events, we do not find evidence of significant excess returns for this group of firms.

Following Espahbodi et al. (2002), we compare mean excess returns between the portfolios of lobbying and non-lobbying firms around each event using F-tests. As shown in the rightmost column of Table 4, we document significant differences between lobbying and non-lobbying firm excess returns around Event 1 (p=0.0125), indicating that investors expect the firms most affected by the possible change to experience greater benefits than other firms. In addition, we find that the combined effect of all 21 events is significantly more positive for the lobbying firms (p=0.0496), and the difference becomes more statistically significant when the confounding effects of Dodd-Frank are excluded (p=0.0143). These results again suggest that investors expect the new WB rules to result in net benefits for the firms most affected.

We now consider whether ambiguity in event interpretation affects the robustness of our findings. As noted above, Events 13 and 19 relate to modifications of the proposed provisions and may be interpreted by investors as negatively rather than positively associated with implementation of the new rules. To allow for this possibility, we reverse code these two events and re-estimate the combined effect of all WB events (with the confounding effects of the DF events removed). As shown in the last row of Table 4, if these events are viewed negatively, mean excess portfolio return for the lobbying firms increases to 0.0487, and the p-value improves to 0.0160, thus strengthening the overall effect. Excess returns for the control portfolio are positive but not significantly different from zero (p=0.2660), and the difference between the lobbying and non-lobbying groups remains highly significant (p=0.0211).

We also consider an alternative interpretation of Event 14, the date on which comment letters were submitted to the SEC. It is possible that investors view lobbying efforts against the proposed rules as negatively affecting the likelihood of their strict implementation. Note that investors must believe that the particular firms lobbying against the proposal will be especially effective in influencing regulators, as lobbying via comment letter submissions is generally expected for all new regulations. In addition, as noted earlier, lobbying efforts could only be effective in influencing limited parameters of the final rules because Congress had already mandated new WB rules that would provide financial incentives to WBs (see footnote 13).

The results reported in Table 4 are instructive on this point. Five events are related to potential rule modification – Events 13, 18, 19, 20, and 21. Two things are worth noting. First, investor reactions around each of these events tend to be similar in magnitude across the lobbying and non-lobbying groups. For example, around Event 13, when the proposed rules were announced with an aim to "ease investor concerns," mean excess portfolio returns for the lobbying and non-lobbying groups are -0.0046 and -0.0030, respectively, and the difference is not significant. In fact, we do not observe a significant difference in investor reactions between the lobbying and non-lobbying firms around any of these events. Second, the reactions around these five events tend to be negative, though not significantly so. The average of the excess returns for these five combined events is -0.0022 for the lobbying group and -0.0016 for the non-lobbying group (not tabulated). These findings suggest that investors do not expect a change in the likelihood of strict implementation of the WB rules to differentially affect these groups, nor do they expect that these potential rule modifications will benefit shareholders.

However, the investor reaction around Event 14 contrasts markedly with the reactions around the rule modification events. The mean excess return for the lobbying group is positive at 0.0082 and significant at a p-value of 0.0584, unlike the average negative reaction around the five modification events. Further, the difference between reactions for the lobbying and non-lobbying groups is highly significant (p=0.0282), in contrast to the five rule modification events, where no significant differences were observed. This suggests that investors view the submission of comment letters as a fundamentally different event than the events related to the release and modification of the WB rules. We thus conclude that it is unlikely that investors view Event 14 as decreasing the likelihood of strict implementation of the WB rules, but rather are reacting to the new information conveyed by lobbying against the proposal – i.e., the magnitude of the rules' economic impact on the firm submitting the comment letter.³²

Overall, the results from Table 4 suggest that investors expect the new WB rules to provide net benefits to the lobbying firms. To explore the possible source of these expected benefits, we exploit our findings from Section V. The results in Table 3 indicate that lobbying firms have significantly weaker existing WB programs and significantly greater managerial entrenchment relative to similar non-lobbying firms. We examine whether investors expect the net benefits of the WB rules to vary systematically across these firm characteristics, which will aid us in interpreting our results from Table 4.

For example, if greater benefits are expected to accrue to the shareholders of firms with weaker existing WB programs, this is consistent with the new rules leading to improved shareholder protection. The availability of direct reporting to the SEC would represent an improvement over the firm's existing WB program or would encourage managers to make value-enhancing improvements to their existing plans. Alternatively, if greater benefits are expected to accrue to shareholders of firms with relatively stronger existing WB programs, this is more consistent with the new rules shifting some of the cost of maintaining the firm's existing WB plans to the SEC. Firms that have already invested heavily in developing strong systems would benefit relatively more from any

 $^{^{32}}$ These findings are also consistent with investors expecting comment letter submissions to influence regulators, but that, *on average*, they view the revelation of which firms are more affected by the new rules as more important economically.

cost-shifting. Note that while some shareholders still benefit in the latter case, this outcome is not the one intended by the SEC.

To determine whether the expected benefits of the new rules vary with the strength of firms' existing WB programs, we split the sample of lobbying firms into high and low strength levels based on the median value of WB_TOT and test whether differences between the portfolio returns for the two groups generate excess returns around the relevant event dates using the Schipper and Thompson (1983) methodology. We subtract the portfolio return for the "High" group from the "Low" group; thus positive (negative) excess returns indicate that firms with weak (strong) existing WB systems benefit from the new rules. As shown in Table 5, we find that the mean excess portfolio return of 0.0323 for the weak firms is marginally significantly positive (p=0.0720) for the combined effect of all the WB events. When the confounding effects of the Dodd-Frank legislative events are removed, the excess return drops to 0.0215 but the significance level improves to 0.0464.³³ These findings are consistent with the expected benefits from the new rules stemming from improved shareholder protection.

We also examine excess portfolio returns by WB strength subscores. We find that the portfolio of firms with low WB program efficacy (WB_PE) has marginally significantly positive excess returns of 0.0245 (p=0.0904) around the combined WB events (with the confounding DF events removed). This subscore measures the importance placed within a firm's Code of Ethics on employee reporting of fraud and misconduct, which suggests that some of the benefit of the new WB rules arises from the emphasis that the SEC publicly places on the role of WBs in uncovering securities violations. The mean return of 0.0166 for the independence of reporting subscore (WB_IR) is even stronger in term of statistical significance (p=0.0392). We thus conclude that at least some of the expected benefits from the new WB rules arises from the availability of independent reporting of financial misconduct to the SEC. We do not find significant differences between portfolio based on low and high WB protection scores (WB_ROT).

We further examine whether expected benefits vary with levels of managerial entrenchment, again splitting the lobbying firms into two groups using median *E-INDEX*.

³³ Results are qualitatively similar when *WB_TOT* is replaced with *SWB_TOT*, with a p-value of 0.0706 for the combined WB effects and 0.0629 when the DF events are removed.

Here we subtract the portfolio return for the "Low" group from the "High" group; thus positive (negative) excess returns indicate that firms with higher (lower) levels of managerial entrenchment benefit from the new rules. As shown in the rightmost column of Table 5, we find that mean excess portfolio returns are more positive for highly entrenched firms. The combined effect for all 21 events is 0.0662 (p= 0.0772), the combined effect for all WB effects is 0.0812 (p=0.0405), and the combined effect for the WB events with the confounding Dodd-Frank events remove is 0.0838 (p=0.0187). These findings are consistent with investors expecting the new WB rules to improve shareholder protection by overcoming the agency conflicts within the firm that might interfere with the resolution of financial misconduct.

The results in Tables 4 and 5 collectively suggest that firms affected by the new WB rules will benefit from improved shareholder protection. However, a limitation of our analysis is that we focus on a sample of firms that is most affected by the new WB rules. The fact that investors expect net benefits to accrue to these firms does not necessarily suggest that they expect net benefits to accrue to the average firm affected by the regulation. To address this issue, we undertake an analysis similar to Zhang (2007) in which we compare the stock returns of U.S. to non-U.S. firms around the 21 event dates. Because the new WB provisions do not apply to non-U.S. firms, we are able to use this international market as a benchmark for U.S. market reactions. We use CRSP equally-weighted and value-weighted market returns to proxy for the portfolio of U.S. firms and the returns on the MSCI World Index (excluding U.S. firms), which captures large and midsize firms across 23 developed markets, as our non-U.S. market benchmark.³⁴ As in Tables 4 and 5, we use the Schipper and Thompson (1983) methodology to determine whether the investor reaction around the WB event dates differs for the two portfolios.

We present results in Table 6. When we use CRSP equally-weighted market returns as our proxy for U.S. firms, we find that U.S. firms experience significantly positive mean excess returns of 0.0388 (p=0.0324) around Event 1 relative to non-U.S. firms, suggesting that investors expect the average U.S. firms to benefit from the SEC's announced plan to compensate WBs. We report similar findings when we use CRSP

³⁴ See <u>http://www.msci.com/products/indexes/country_and_regional/dm/performance.html</u>. Note that to the extent that the CRSP market returns include cross-listed firms, this will bias against our findings differences between the U.S. and non-U.S. firms.

value-weighted market returns, though the mean excess return of 0.0313 is slightly smaller and the p-value increases to 0.0801, suggesting that investors expect smaller firms to benefit more from the possible regulatory change than larger firms.

Our inferences are unchanged when we examine the combined effect of all the events related to the WB provisions. As shown in the bottom row of Table 6, the combined effect of all WB events when the confounding effects of the Dodd-Frank events are removed is a significantly positive mean excess return of 0.1591 (p=0.0360) and 0.1245 (0.0896) for the CRSP equally-weighted and value-weighted market proxies, respectively, consistent with investors expecting the average U.S. firm to receive net benefits from the regulatory change.

Finally, in the rightmost column of Table 6, we examine whether investors expect the U.S. firms that lobbied against the WB provisions to receive greater benefits than the average U.S. firm. (Note that this comparison is almost identical to that reported in Table 4, column 1, except that our market benchmark is now the MSCI World Index rather than the US market.) Consistent with the results from Table 4, we find that the firms most affected by the WB rules do indeed experience more significantly positive excess returns than the average firm. After removing the confounding effects of the Dodd-Frank events, the mean excess return for portfolio of lobbying firms is 0.0476 (p=0.0274). We thus conclude that investors perceive the new WB rules as providing net benefits to shareholders, consistent with the SEC's intentions.

VII. CONCLUSIONS

In this paper, we empirically evaluate the expected net costs and benefits of the whistleblower program adopted under the Dodd-Frank Reform Act of 2010 by examining investor responses to the proposed regulation. Our results indicate that investors expect the new WB rules to provide net benefits to the firms most affected by the provisions, as well as to the average U.S. firm. In addition, the results of cross-sectional tests are consistent with the benefits arising from improved shareholder protection, consistent with the SEC's intention. The paper extends the literature on compliance and business ethics, whistleblowing, corporate lobbying, and the economic consequences of regulation.

There are several limitations to our study. First, as in prior research, we assume that firms that lobby the SEC regarding the proposed WB provisions via comment letter submissions represent those most affected by the new regulations. Supplemental analyses related to firms' meetings with the SEC, financial contribution to PACs and lobbying expenditures provide additional evidence consistent with this assumption. However, to the extent that our sample selection process has misidentified those most affected, the power of our empirical tests will be reduced. Second, our tests rely on a self-constructed index of WB program strength based on descriptions provided in each firm's Code of Ethics; we are unable to directly measure how the firm is actually implementing the WB program. While we have made efforts to ensure content validity by basing our index on WB program guidelines developed by the ICC and have performed numerous tests of construct validity, to the extent that our measure does not adequately capture the strength of WB programs as implemented in practice, this will also reduce statistical power. The paper is also subject to the unobservability of investor expectations, which Leftwich (1981) identifies as one of the fundamental limitations of event studies. Finally, we do not explore the social welfare implications of the new WB rules, as social benefits may not be fully reflected in equity prices (Watts and Zimmerman 1986). Future research might be directed toward investigating the social benefits of financial regulation.

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APPENDIX A Validity Tests of the WB Program Strength Index

The strength of an internal WB program is difficult to measure because the development and application of a WB program index requires subjective assessments by the researchers applying the technique. While we use the ICC Guidelines on Whistleblowing (ICC 2008) to develop our measure and help ensure its content validity, the scoring process nevertheless does entail some subjectivity. As a result, it is important to assess the internal consistency and external construct validity of the resulting measure.

We employ several approaches to assess the internal consistency of our index. First, as observed in Panel B of Table 2, the three subscores WB_PE , WB_IR , and WB_PROT used in creating our overall index of WB program strength are positively correlated with one another. This gives us some assurance of internal consistency. We also calculate Cronbach's alpha, which measures the degree to which correlation among measurements is attenuated due to random error. The standardized score for the three categories used to construct WB_TOT is 0.583, which is slightly below the suggested cutoff of 0.70. We also perform a factor analysis and find that all three subscores load on a single factor, with about 55% of the total variation explained. These results suggest that random measurement error may reduce the power of our tests.^{35,36}

We also assess the external validity of our index by comparing our scoring to an independent source that evaluates written Codes of Ethics more broadly. Ethisphere Institute, a leading authority on rating of business codes, reviewed over 800 Codes of Ethics from 2007 to 2010 as part of a benchmarking exercise aimed at identifying best practices in business ethics. The Institute's panel of experts assigned a standard grade (A = excellent, B = above average, C = average, D = below average, F = poor) to firms' Code of Ethics based on eight categories: 'Public Availability', 'Tone from the Top', 'Readability and Tone', 'Non-Retaliation and Reporting', 'Commitment and Values',

³⁵ Botosan (1997) reports comparable statistics in her validity tests of a self-constructed disclosure index. She reports a Cronbach's alpha of 0.68 and notes that the amount of variance explained in a factor analysis was approximately 48%.

³⁶ These analyses implicitly assume that the three subscores used to construct the WB program strength index *should* be correlated with one another, which is debatable. For example, one can imagine a case where a firm places a high importance on employee reporting of fraud, resulting in a high program efficacy score, but has the employee report fraud only to management and not the audit committee, resulting in a low independence of reporting score.

'Risk Topics', 'Comprehension Aids', and 'Presentation and Style'. As in Erwin (2011), we use these ratings as a measure of Code of Ethics quality for 89 lobby and non-lobby firms included in Ethisphere Institute's benchmarking analysis. The quality of firms' WB program should be correlated in a predictable manner with the quality of its broader Code of Ethics. We find that WB PE is positively correlated with Tone from the Top (correlation of 0.1877, p=0.0714), suggesting firms with management commitment to values outlined in the Code of Ethics place greater emphasis on requiring the reporting of fraud. Since none of Ethisphere's eight categories rate independence of reporting, which is the focus of WB IR, we do not expect nor do we find any correlation between these categories and WB IR. However, we do find a positive association between the contact information availability sub-component of WB IR and Public Availability (correlation of 0.1863, p=0.0805), providing evidence that firms with more accessible Code of Ethics also have more accessible whistleblower reporting contact information. We also find that WB PROT is positively correlated with Non-Retaliation and Reporting (correlation of 0.1796, p=0.0921), suggesting firms with non-retaliation and reporting policies provide greater protection to WBs. These results suggest our WB index has good external validity in that it correlates in a predictable manner with Ethisphere Institute's ratings of the broader Code of Ethics.

Another concern is that our reliance on published codes may fail to capture how compliance programs are implemented in practice. We therefore consider how membership in the Society of Corporate Compliance and Ethics (SCCE) correlates with our WB index. The SCCE's mission is "...to champion ethical practice and compliance standards in all organizations and to provide the necessary resources for compliance professionals and others who share these principles." We expect membership in this organization to reflect a broader commitment to corporate compliance and ethics. We obtain a list of corporate members from the organization's website.³⁷ Of the 35 entities listed, we were able to obtain codes for 23. We compute a WB strength score using our coding methodology, and then compare the score of the 23 SCCE members to all of our

 $^{^{37}}$ The SCCE provides a list of its corporate members at:

http://www.corporatecompliance.org/Membership/AboutSCCEMembership/ViewCorporateMembers.aspx.

lobby and non-lobby firms.³⁸ The mean WB_TOT score of SCCE organizations is 11.96. This mean score is significantly higher than the mean score of 9.09 for lobby nonmember firms (p=0.0001), and also higher than the mean score of 10.84 for non-lobby non-member firms in our control sample (p=0.0961). Higher WB_TOT scores for SCCE members suggests that firms committed to corporate ethics and high quality compliance programs also adopt stronger written codes for whistleblowing.

Another useful source of data to validate our coding comes from the U.S. Federal Sentencing Guidelines for Organizations. These guidelines allow for leniency in sentencing of firms with effective compliance programs, and mandate seven minimum requirements that firms' compliance programs must meet in order to result in a reduced sentence. While the first of these requirements relates to written standards and procedures, the remaining requirements focus on elements of *implementation*, such as board oversight, employee training, periodic risk assessments and program audits, and prompt response to offenses followed by corrective action. In a 2003 memo explaining the basic principles to be followed in prosecuting business organizations, Deputy Attorney General Larry Thompson instructed prosecutors to "… attempt to determine whether a corporation's compliance program is merely a 'paper program' or whether it was designed, and implemented in an effective manner." These assessments are thus particularly useful in ensuring that our WB index correlates with program effectiveness.

We examine a sample of 48 firms charged under the Foreign Corrupt Practices Act (FCPA) by the U.S. Department of Justice (DOJ) or the SEC. Compliance program assessments made by the DOJ and the SEC, both of which use the Sentencing Guidelines in FCPA actions, provide an opportunity to assess whether our WB program index captures how compliance programs are implemented in practice. Beginning in 2010, both the DOJ and the SEC began publicly acknowledging strong compliance programs as a rationale for entering into non-prosecution agreements with firms charged under the FCPA.³⁹ We identify 8 of these "strong compliance" firms and calculate their index of WB program strength – mean *WB_TOT* for this group is 12.88. We also identify 26 firms

 $^{^{38}}$ There are five members who are also sample lobby / non-lobby firms. We include these firms in the SCCE member list and remove them from our sample for purposes of this calculation.

³⁹ For example, in its 2010 agreement with Noble Corporation, the DOJ specifically cited "the existence of Noble's pre-existing compliance program and steps taken by Noble's Audit Committee to detect and prevent improper conduct from occurring" (DOJ 2010, p. 1).

that the DOJ or SEC publicly acknowledged as having implemented a strong compliance program after a violation had occurred – mean WB_TOT for these "improved compliance" firms is 11.54. Finally, we identify 14 firms that settled charges without the DOJ or SEC citing a strong or improved compliance program – mean WB_TOT for these "no comment" firms is 8.71. Both the "strong compliance" and the "improved compliance" groups have significantly higher mean WB_TOT scores than the "no comment" group, with p-values of 0.0023 and 0.0360, respectively. These results suggest our WB program measure has good external validity in that it correlates well with DOJ and SEC compliance program assessments, which capture both the design and implementation of corporate compliance programs.

As an additional related test, we also examine a sample of 35 firms with Corporate Integrity Agreements (CIAs) in place with the U.S. Department of Health & Human Services (DHHS) between 2005-2009. Firms agree to CIAs as part of settlements related to federal health care program investigations (e.g. medicare fraud) in order to avoid being excluded from participation in future federal health care programs. A CIA typically lasts five years and requires annual compliance audits by an independent auditor, mandatory self-reporting of any new violations, and an annual implementation report to the DHHS describing the status of the firm's compliance activities. In contrast to FCPA actions in which the DOJ or SEC evaluate firms' compliance programs at a point in time, CIAs help us identify a subset of firms with strong incentives to implement an effective compliance program over a longer period of time. The mean WB TOT score for "CIA" firms is 12.03, which is significantly higher than the mean score of 9.10 (10.85) for lobby (non-lobby) firms, with p-values of 0.0001 and 0.0273, respectively. As firms in the health care industry may have stronger WB programs due to the pre-existing FCA whistleblower program, we also use lobby and non-lobby firms in the health care industry as an alternative benchmarking group - the mean WB TOT score of CIA firms is also statistically higher than the mean score of 10.00 for this alternative group (p=0.0313).

In sum, we believe our index of WB program strength has good content and external construct validity, but exhibits a slightly weaker internal consistency that may weaken the overall power of our empirical tests.

APPENDIX B Supplemental Tests of Issue Salience

As discussed in Section 3, our decision to expand our sample selection procedure to include firms that lobby either individually or collectively via comment letter submissions to the SEC may potentially reduce issue salience for our sample firms. In this appendix, we examine other political activities related to the proposed WB regulations of our lobbying and non-lobbying firms to provide additional evidence regarding issue salience.

We refer to Oberman's (1993) typology of corporate political tactics in identifying other potential approaches to political action. For example, Oberman (1993) distinguishes between public versus private breadth of transmission to decision makers and between communication content based on "information" versus "pressure." To illustrate, attempting to influence regulators via submission of a comment letter to the SEC's website is an example of a public information political strategy. In our supplemental analyses, we examine both private information tactics, i.e., traditional lobbying through meetings with regulators and lobbying expenditures, and private pressure tactics, as represented by firms' political action committee (PAC) contributions. If the sample firms we identified through a public information political tactic are those most affected by the WB regulations, we also expect to observe greater reliance on private information and private pressure political tactics for these firms relative to their matched controls. We describe these additional measures of political activity in detail below.

Analysis of PAC Contributions. On May 11, 2011, Congressman Michael Grimm (R, C-NY) introduced draft legislation at a hearing in the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises (henceforth "Subcommittee") entitled "Legislative Proposal to Address Negative Consequences of the Dodd-Frank Whistleblower Provisions." This legislation was formally introduced on July 11, 2011 as "The Whistleblower Improvement Act of 2011" (H.R. 2483). The main feature of the proposed legislation is to require employees to report misconduct to their employers prior to reporting it to the SEC in order to be eligible to receive a monetary reward. On December 14, 2011, the Subcommittee voted 19-14 in favor of advancing the

legislation, with this particular requirement included, referring it to the full Financial Services Committee for additional consideration.

This circumstance allows us to use PAC contributions to the 33 voting members of the Subcommittee as an alterative measure of the salience of the WB regulations for our sample and control firms. We examine PAC contributions from our lobbying/non-lobbying firms to the 19 House Representatives who voted in favor of the above legislation (hereafter referred to as "anti-SEC reporting" positions), as well as those to the 14 Representatives who voted against it (referred to as "pro-SEC reporting"). A firm-Representative level measure is particularly powerful in this setting, given the existence of the above voting record that allow us to directly observe the position of each Representative on the contentious issue of direct reporting to the SEC.

We obtain data from the Center for Responsive Politics on contributions made by the PACs of lobbying and non-lobbying firms during calendar year 2011. We measure PAC contributions during this time because if lobbying firms attempted to use their political connections with House Representatives to pursue legislative reform of the WB regulations, they likely did so between the time from their submission of comment letters to the SEC in December 2010 to the Subcommittee vote on the amendments in December 2011. We use PAC contributions as a measure of political connection but acknowledge that PAC receipts represent only a portion of any Representatives' total political receipts.

Panel A of Table B1 reports mean and median PAC contributions received by Subcommittee members from lobbying and non-lobbying firms, expressed as a percentage of the total dollar amount of PAC receipts received. We first conduct withinsample analyses to assess differences in political connections between anti- and pro-SEC reporting Representatives. The mean (median) percentage of PAC funding from lobbying firms to anti-SEC reporting Representatives is 5.86% (5.10%) of those congresspersons' total PAC receipts versus 2.52% (2.02%) for pro-SEC reporting Representatives. Differences in both means and medians are significant, at p-values of 0.0006 and 0.0003, respectively. This indicates that firms that lobbied against the WB provisions were also more politically connected to House Representatives who voted against the SEC's proposal than those who voted for it. The mean (median) percentage of PAC funding from non-lobbying firms to anti-SEC reporting Representatives of 4.10% (4.06%) is also greater than the mean (median) of 2.63% (3.56%) for pro-SEC reporting Representatives, but at slightly lower levels of significance, with p-values of 0.0396 and 0.0686. Therefore, both groups were more politically connected to anti- than pro-SEC reporting Representatives. This result is not all that surprising as anti-SEC reporting Representatives, relative to pro-SEC reporting Representatives, are more likely to be "pro-business" and thus should receive a greater proportion of funding from corporations.

A between-sample analysis yields additional insights. The mean (median) percentage of PAC funding received by anti-SEC reporting Representatives from lobbying firms of 5.86% (5.10%) is significantly greater than the mean (median) of 4.10% (4.06%) reported for non-lobbying firms; the p-value for differences in means (medians) is 0.0158 (0.0206). In contrast, there is no statistical difference between mean (median) contributions to pro-SEC reporting Representatives from lobbying versus non-lobbying firms. In addition, as indicated in the third row of Panel A, the difference in contributions between lobbying and non-lobbying firms is greater for anti-SEC reporting Representatives, with mean and median "differences in differences" significant at 0.0603 and 0.0461, respectively. Together, these results suggest that lobbying firms are more politically connected to anti- than pro-SEC Representatives and that these political connections are stronger than the connections that exist between non-lobbying firms and anti-SEC Representatives.

The magnitude of PAC contributions may be understated in Panel A of Table B1, as we exclude foreign firms, private firms, and firms without matches in defining our sample of lobbying firms. In addition, our evidence from Table 1 indicates that many non-corporate entities also opposed direct reporting to the SEC. In Panel B of Table B1, we compare the percentage of PAC funding received by anti- and pro-SEC reporting Representatives from all submitters (corporations, non-investor groups, investment advisor/investor groups, accounting and law firms) that opposed direct reporting PACs to anti-SEC reporting Representatives is 17.71% (17.05%) of those politicians' total PAC receipts, which is significantly greater than the mean (median) PAC contribution received by pro-SEC reporting Representatives from this same group – 10.06% (11.90%). P-values for the difference in means (medians) is 0.0022 (0.0051). These results provide additional

evidence that entities opposed to the WB regulations were also significantly more politically connected to Representatives who ultimately voted against the new WB rules.

Analysis of Lobbying Expenditures. We also examine whether firms that lobby via comment letter submissions against the WB provisions are also more likely to incur lobbying expenditures related to the Whistleblower Improvement Act of 2011 or to the Investor Protection Act of 2009 (in which the SEC's WB program was first introduced), than are non-lobbying firms. While lobbying expenditures have the advantage of being economically significant, as they are typically many more times greater than PAC contributions (Yu and Yu 2011), one disadvantage is that we cannot observe whether firms that incur lobbying expenditures support or oppose the particular Act in question, nor can we obtain the magnitude of the expenditures specifically related to these two Acts. Nonetheless, examining whether lobbying expenditures related to these two Acts were incurred should help in validating our assumption regarding the salience of the WB provisions for our sample firms versus their matched controls. We obtain data on lobbying activity pertaining to the two Acts from the Center for Responsive Politics. As shown in Panel C, we find that the percentage of lobbying firms that incur expenditures related to the two Acts is marginally significantly higher than that of non-lobbying firms.

Meetings with SEC Officials. We also examined whether firms met with SEC officials to discuss aspects of the WB provisions between December 6, 2010 and April 15, 2011, based on information provided on the SEC website. Almost 12% of our sample of lobby firms met with the SEC during this time period while only 1% of the matched control firms did so, a difference significant at the 0.001 level. Twelve of the sample firms are co-signers of the ACC letter; almost all (22) come from the four co-signed submissions. On average, these 23 firms held 4 meetings with SEC officials, often on more than one date. One firm had 10 meetings. Collectively this analysis provides additional evidence of political action taken by our sample of comment letter submitters and supports our maintained assumption that lobbying firms are more affected by the WB provisions than non-lobbying firms.

TABLE B1Supplemental Tests of Issue Salience

Panel A: Financial contributions from *LOBBY* and *non-LOBBY* firm PACs to anti- and pro-SEC reporting representatives

	Mean			Median		
	Anti-SEC reporting	Pro-SEC reporting	<i>p</i> =value for	Anti-SEC reporting	Pro-SEC reporting	<i>p</i> =value for
	representatives (N=19)	representatives (N=14)	difference	representatives (N=19)	representatives (N=14)	difference
\$ from <i>LOBBY</i> firms	5.862	2.519	0.0006	5.103	2.017	0.0003
\$ from <i>non-LOBBY</i> firms	4.099	2.634	0.0396	4.058	3.556	0.0686
Difference	1.763	-0.115	0.0603	1.045	-1.540	0.0461
p=value for difference	0.0158	0.8623		0.0206	0.8013	
Panel B: Financial contributions from all ant	-SEC reporting lobbyin	g entity PACs to anti- ar	nd pro-SEC rep	orting representatives		
	Mean			Median		
	Anti-SEC reporting	Pro-SEC reporting	<i>p</i> =value for	Anti-SEC reporting	Pro-SEC reporting	<i>p</i> =value for
	representatives (N=19)	representatives (N=14)	difference	representatives (N=19)	representatives (N=14)	difference
\$ from all anti-SEC reporting lobbying entities	17.708	10.062	0.0022	17.052	11.899	0.0051
Panel C: Firms with lobbying expenditures of	n related WB Acts					
	LOBBY firms	non-LOBBY firms	<i>p</i> =value for			
	(N=188)	(N=188)	difference			
% of firms with lobbying expenditures	3.723	2.128	0.0832			

Panels A and B of Table B1 examine PAC funding sources for voting members of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises. Anti- (pro-) SEC reporting Representatives are defined as those Subcommittee members who supported (opposed) a requirement that whistleblowers first report misconduct to employers before reporting it to the SEC, as indicated by their vote for (against) an amendment

eliminating this requirement on 12/14/11. Anti-SEC reporting lobby entities are the PACs of all submitters (corporations, non-investor groups, investment advisor/investor groups, accounting and law firms) who took an anti-SEC reporting position in their comment letters on the proposed WB rules. PAC is Political Action Committee.

\$'s represent the ratio of the congressperson's PAC receipts from a particular entity (*LOBBY*, non-*LOBBY* firm, or anti-SEC lobbying entities) to her/his receipts from all PACs, where PAC receipts are measured for calendar 2011.

Panel C of Table B1 examines the proportion of *LOBBY* and *non-LOBBY* firms incurring lobbying expenditures on recent WB legislation (H.R. 3817 Investor Protection Act of 2009 or H.R. 2483 Whistleblower Improvement Act of 2011).

All differences in means (medians) are reported using a two-tailed t-test (Wilcoxon rank sum test).

Submitter Type	Total	Corporation	Non-Investor	Individual	Investment Advisor/	Accountant/	Lawyer/
			Group		Investor Group	Accounting Firm	Law Firm
Panel A: Overall As	ssessment of Prop	osed Rules					
				Overall Assessmen	nt		
No. pos./neu./neg.	156/3/361	0/0/283	18/0/24	100/2/13	3/1/17	6/0/3	27/0/14
Percent positive	30%	0%	43%	87%	14%	67%	66%
Panel B: Direct Rep	porting to the SE	C by the Whistlebl	ower				
		Repo	orting through Corport	ate Internal Compl	liance Systems not Required	!	
No. pos./neu./neg.	94/2/365	0/0/283	10/0/31	75/0/1	0/1/18	1/0/6	7/1/20
Percent positive	20%	0%	24%	99%	0%	14%	25%
			Eligibility of Whi	stleblowers not Re	porting Internally		
No. pos./neu./neg.	13/0/343	0/0/278	6/0/24	0/0/3	0/0/18	1/0/4	5/0/11
Percent positive	4%	0%	20%	0%	0%	20%	31%
			No Requiremen	t to Disclose of All	egation to Firms		
No. pos./neu./neg.	6/0/313	0/0/269	1/0/11	3/0/0	0/0/21	1/0/0	1/0/7
Percent positive	2%	0%	8%	100%	0%	100%	13%
		Ninety-de	ay Window to Submit I	information to the	SEC after Submitting Interr	nally	
No. pos./neu./neg.	2/0/329	0/0/270	2/0/21	0/0/0	0/0/19	0/0/2	0/0/11
Percent positive	1%	0%	9%	-	0%	0%	0%
Panel C: Enhanced	Financial Rewar	rds to Whistleblow	vers				
			P	Payment of an Awa	rd		
No. pos./neu./neg.	15/0/8	0/0/0	1/0/0	9/0/6	1/0/0	0/0/0	3/0/2
Percent positive	65%	-	100%	60%	100%	-	60%
			Adjustments to .	Awards to Culpabl	le Whisteblowers		
No. pos./neu./neg.	4/0/318	0/0/262	1/0/21	0/0/2	0/0/19	3/0/6	0/0/4
Percent positive	1%	0%	5%	0%	0%	33%	0%

TABLE 1 Summary of Comment Letters Submitted to the SEC

TABLE 1 - Continued

Submitter Type	Total	Corporation	Non-Investor	Individual	Investment Advisor/	Accountant/	Lawyer/
			Group		Investor Group	Accounting Firm	Law Firm
Panel D: Enhanced	Whistleblower P	rotection					
			Extend	led Retaliation Pro	tection		
No. pos./neu./neg.	387/0/14	249/0/1	14/0/3	88/0/5	15/0/1	2/0/0	16/0/4
Percent positive	97%	100%	82%	95%	94%	100%	80%
		I	Prohibition of action the	hat impedes commi	unications with the SEC		
No. pos./neu./neg.	6/0/13	0/0/7	0/0/2	6/0/0	0/0/0	0/0/0	0/0/4
Percent positive	32%	0%	0%	100%	-	-	0%
Panel E: Limits to the	he Rewards and	Protection Provide	ed to Whistleblowe	rs			
			Ν	lo Amnesty Provide	ed		
No. pos./neu./neg.	334/0/9	275/0/0	27/0/2	2/0/1	16/0/1	1/0/1	10/0/3
Percent positive	97%	100%	76%	67%	94%	50%	77%
			Exclusion Depende	ing on How Inform	ation was Obtained		
No. pos./neu./neg.	341/0/9	267/0/0	19/0/3	6/0/1	19/0/0	6/0/1	18/0/4
Percent positive	97%	100%	86%	86%	100%	86%	82%
Panel F: Administra	tive Process						
			Reasonable	e Process for Filing	g Complaint		
No. pos./neu./neg.	1/0/38	0/0/15	0/0/7	1/0/3	0/0/0	0/0/2	0/0/10
Percent positive	3%	0%	0%	25%	-	0%	0%
			Rules Suffici	ently Clear and Un	nderstandable		
No. pos./neu./neg.	0/0/317	0/0/260	0/0/20	0/0/6	0/0/16	0/0/3	0/0/10
Percent positive	0%	0%	0%	0%	0%	0%	0%

TABLE 2Characteristics of Lobby and Non-Lobby Firms

Variable	Mean	Median	Min	Max	Mean	Median	Min	Max	<u>t-test</u>	Wilcoxon
	LOI	BBY firms	s (N=1	88)	non-l	LOBBY fir	ms (N⁼	=188)	<i>p</i> -value for	or difference
Total WB Program Strength (WB_TOT)	9.101	9.0	2	16	10.846	11.0	0	16	0.0001	0.0001
WB Program Efficacy (WB PE)	1.638	2.0	0	3	1.931	2.0	0	3	0.0009	0.0006
Reporting by Employees Mandatory	0.942	1.0	0	2	1.133	1.0	0	2	0.0056	0.0064
Firm Commitment to Follow-up	0.697	1.0	0	2	0.798	1.0	0	1	0.0262	0.0239
Independence of Reporting (WB IR)	4.362	4.0	0	8	5.447	6.0	0	8	0.0001	0.0001
Option to Report to Different Parties	0.963	1.0	0	1	0.952	1.0	0	1	0.6105	0.6108
Independence of Highest Party of Reporting Line	1.910	2.0	0	4	2.564	2.5	0	4	0.0001	0.0001
Reporting Line Emphasis	0.723	1.0	0	2	1.075	1.0	0	2	0.0001	0.0001
Contact Information Availability	0.766	1.0	0	1	0.856	1.0	0	1	0.0251	0.0253
WB Retaliation Protection (WB PROT)	3.101	3.0	0	6	3.468	4.0	0	7	0.0048	0.0008
Anonymous Reporting Permitted	0.840	1.0	0	1	0.899	1.0	0	1	0.0925	0.0926
Confidentiality of WB	0.782	1.0	0	2	1.016	1.0	0	2	0.0006	0.0010
Feedback Provided to WB	0.176	0.0	0	2	0.245	0.0	0	2	0.1910	0.2878
Retaliation Protection	1.303	1.0	0	2	1.309	1.0	0	2	0.9242	0.7460

Panel A: Univariate differences between LOBBY and non-LOBBY firms for WB Program Strength Variables

TABLE 2 (continued)

Panel B: Univar	iate differences	between LOI	BBY and non-	LOBBY firms					
Variable	Mean	Median	Std. Dev.	Mean	Median	Std. Dev.	<u>t-test</u>	Wilcoxon	
	LOBBY firm	ns (N=188)		non-LOBBY	firms (N=18	<i>p</i> -value for	<i>p</i> -value for difference		
LEV	0.192	0.164	0.172	0.220	0.199	0.181	0.1340	0.1266	
FCF	0.059	0.060	0.083	0.061	0.054	0.084	0.8693	0.8647	
ROA	0.013	0.027	0.110	0.015	0.030	0.120	0.8481	0.5144	
AGE	29.452	23.500	18.457	27.511	21.000	18.664	0.3112	0.2437	
WB TOT	9.101	9.000	2.652	10.846	11.000	3.080	0.0001	0.0001	
WB_PE	1.638	2.000	0.882	1.931	2.000	0.808	0.0009	0.0006	
WB_IR	4.362	4.000	1.778	5.447	6.000	1.771	0.0001	0.0001	
WB_PROT	3.101	3.000	1.121	3.468	4.000	1.374	0.0048	0.0008	
E-INDEX	2.782	3.000	1.513	2.160	2.000	1.515	0.0001	0.0002	
CEO=COB	0.590	1.000	0.493	0.479	0.000	0.501	0.0299	0.0302	
MGTOWN	0.093	0.030	0.142	0.105	0.041	0.158	0.4379	0.2934	
ICW	0.218	0.000	0.414	0.192	0.000	0.395	0.5241	0.5238	
RESTATE	0.245	0.000	0.431	0.239	0.000	0.428	0.9045	0.9048	
IDIOSYN	-3.149	-3.163	0.704	-3.147	-3.083	0.755	0.9834	0.7832	
#_WB_ALLEG	0.133	0.000	0.424	0.069	0.000	0.293	0.0908	0.0912	
BLOCKOWN	0.255	0.231	0.159	0.249	0.236	0.182	0.7189	0.4557	
BTM	0.561	0.464	0.410	0.619	0.520	0.486	0.2063	0.3824	
	non-financia	ll <i>LOBBY</i> firm	ns (N=164)	non-financia	l non-LOBBI	Y firms (N=164) <u>p</u> -value for	difference	
ABSDACC	0.080	0.046	0.091	0.067	0.043	0.071	0.1413	0.4425	

Panel C: Co	orrelatio	ns betwe	en indep	endent v	ariables												
	LEV	FCF	ROA	AGE	WB_TOT	WB_PE	WB_IR	WB_PROT	E-INDEX	CEO = COB	MGTOWN	ICW	RESTATE	IDIOSYN	ABSDACC	#_WB_ALLEG	BLOCKOWN
FCF	-0.1166																
	(0.0237)																
ROA	-0.0842	0.5536															
	(0.1030)	(0.0001)															
AGE	0.0415	0.0679	0.2011														
	(0.4229)	(0.1890)	(0.0001)														
WB_TOT	0.1549	0.0172	0.0457	0.1050													
	(0.0026)	(0.7393)	(0.3766)	(0.0420)													
WB_PE	0.1433	0.0776	0.0821	0.0820	0.5660												
	(0.0054)	(0.1331)	(0.1120)	(0.1126)	(0.0001)												
WB_IR	0.1018	-0.0118	-0.0143	0.0208	0.8348	0.1968											
	(0.0485)	(0.8191)	(0.7830)	(0.6877)	(0.0001)	(0.0001)											
WB_PROT	0.1211	0.0056	0.0737	0.1629	0.7647	0.3762	0.3811										
	(0.0189)	(0.9140)	(0.1539)	(0.0015)	(0.0001)	(0.0001)	(0.0001)										
E-INDEX	0.0381	-0.0110	-0.0473	-0.0782	-0.0641	0.0164	-0.0644	-0.0688									
	(0.4616)	(0.8315)	(0.3605)	(0.1302)	(0.2151)	(0.7515)	(0.2132)	(0.1834)									
CEO=COB	0.0369	0.0252	0.0163	0.2316	0.0504	0.0579	0.0526	0.0034	-0.0125								
	(0.4756)	(0.6266)	(0.7528)	(0.0001)	(0.3293)	(0.2625)	(0.3095)	(0.9480)	(0.8088)								
MGTOWN	-0.1014	-0.0981	-0.1369	-0.2983	-0.0087	-0.0313	0.0363	-0.0526	-0.1308	-0.1678							
	(0.0495)	(0.0573)	(0.0079)	(0.0001)	(0.8663)	(0.5456)	(0.4833)	(0.3091)	(0.0111)	(0.0011)							
ICW	-0.0536	-0.1003	-0.1292	-0.0797	0.0023	-0.0417	0.0369	-0.0204	-0.0524	-0.0946	0.0007						
	(0.3001)	(0.0520)	(0.0122)	(0.1231)	(0.9645)	(0.4205)	(0.4753)	(0.6933)	(0.3113)	(0.0668)	(0.9889)						
RESTATE	0.0377	-0.1237	-0.0968	-0.1520	-0.0344	-0.1189	0.0292	-0.0437	-0.0719	-0.0578	-0.0580	0.4211					
	(0.4667)	(0.0164)	(0.0608)	(0.0031)	(0.5065)	(0.0211)	(0.5721)	(0.3980)	(0.1644)	(0.2632)	(0.2624)	(0.0001)					
IDIOSYN	-0.1211	0.2577	0.4180	0.2401	0.0548	0.0583	-0.0075	0.1014	-0.0324	0.0748	-0.2348	-0.1999	-0.1933				
	(0.0188)	(0.0001)	(0.0001)	-0.0001	(0.2893)	(0.2596)	(0.8846)	(0.0494)	(0.5311)	(0.1479)	(0.0001)	(0.0001)	(0.0002)				
ABSDACC	-0.0432	-0.1607	-0.2642	-0.2003	-0.0645	-0.0985	-0.0111	-0.0677	-0.0017	-0.0640	0.1351	0.0747	0.0037	-0.2382			
	(0.4355)	(0.0035)	(0.0001)	(0.0003)	(0.2442)	(0.0750)	(0.8409)	(0.2212)	(0.9760)	(0.2480)	(0.0144)	(0.1774)	(0.9463)	(0.0001)			
#_WB_ALLEG	-0.0294	0.0351	0.0792	0.1092	-0.0250	-0.0648	0.0334	-0.0644	-0.0989	0.0968	-0.0640	-0.0526	0.0019	0.1141	-0.0432		
	(0.5696)	(0.4976)	(0.1253)	(0.0343)	(0.6285)	(0.2103)	(0.5189)	(0.2130)	(0.0553)	(0.0609)	(0.2159)	(0.3088)	(0.9702)	(0.0269)	(0.4357)		
BLOCKOWN	0.1324	-0.0298	-0.0942	-0.20981	-0.0417	-0.0736	0.0135	-0.0687	0.1123	-0.0893	-0.0886	0.1912	0.1397	-0.2782	0.0748	-0.0677	
	(0.0102)	(0.5648)	(0.0681)	(0.0001)	(0.4203)	(0.1542)	(0.7947)	(0.1839)	(0.0294)	(0.0839)	(0.0863)	(0.0002)	(0.0066)	(0.0001)	(0.1765)	(0.1905)	
BTM	-0.0366	-0.2963	-0.1495	-0.0595	-0.1009	-0.1132	-0.0435	-0.0987	-0.0544	0.0061	0.0617	0.0151	0.1075	-0.2701	-0.0749	-0.0147	0.07743
	(0.4789)	(0.0001)	(0.0037)	(0.2498)	(0.0507)	(0.0282)	(0.3999)	(0.0558)	(0.2924)	(0.9064)	(0.2325)	(0.7710)	(0.0372)	(0.0001)	(0.1757)	(0.7766)	(0.1340)

 TABLE 2 (continued)

TABLE 2 (continued)

Panels A and B Table 2 compare the firm characteristics of *LOBBY* and *non-LOBBY* firms. Details of WB Program Strength are reported in Panel A; all independent variables from equation (1) are reported in Panel B. In both Panels A and B of Table 2, the *t*-test is reported for the parametric test on differences in the mean across the two samples. The Wilcoxon rank sum test is reported for the nonparametric test for whether the two samples of observations come from the same distribution.

Pair-wise Pearson correlation coefficients are reported in Panel C of Table 2, with significance levels in parentheses. The sample size is 378 for all pair-wise correlations except for those involving the variable *ABSDACC*. Here, financial firms (SIC codes 6000 through 6999) are excluded and the sample size is 328. These correlations and significance levels are indicated in italics.

We include four self-constructed measures for the strength of a firm's whistleblowing program, based on descriptions provided within each firm's Code of Ethics – program efficacy (WB_PE), independence of reporting (WB_IR), and protection provided to WBs (WB_PROT). Overall WB strength (WB_TOT) is computed as the sum of the three categories.

Leverage (*LEV*) is defined as long-term debt divided by total assets. *FCF* is operating cash flow less capital expenditures divided by total assets. *ROA* is defined as income before extraordinary items divided by total assets. *AGE* is the number of years the firm appears on Compustat. *LEV*, *ROA* and *AGE* are all measured at the end of 2009. Entrenchment index (*E-INDEX*), is measured as the sum of six indicator variables for corporate governance provisions: staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments. *E-INDEX* thus ranges from zero to six. CEO duality (*CEO=COB*) is an indicator variable that equals one if the firm combines the CEO and Chairman of the Board positions, and zero otherwise. Managerial stock ownership (*MGTOWN*) represents the percentage of stock owned by the top five executives of the firm. *CEO=COB* and *MGTOWN* are obtained from firms' 2009 proxy statements filed with the SEC. Internal Control Weakness (*ICW*) is as an indicator variable that equals one if the firm's financial statements contained a misstatement during fiscal 2005 through 2009, and zero otherwise. *IDIOSYN* is the firm's idiosyncratic stock return volatility for fiscal 2009, measured using firm-specific regressions of weekly stock returns on market and industry returns. We measure absolute value of discretionary accruals (*ABSDACC*) based on the Jones (1991) model for fiscal 2009. #_*WB_ALLEG*, captures the number of times a firm has been named in a WB complaint by OSHA or the press, over the 2007-2009 period. *BLOCKOWN*, is defined as the percentage of stock owned by blockholders measured at the end of 2009. *BTM* is defined as the annual book value per share divided by price per share at the end of fiscal 2009.

TABLE 3 A Multivariate Comparison of Lobbying and Non-Lobbying Firms

$Pr(LOBBY) = \alpha_0 + \alpha_1 LEV + \alpha_2 FCF + \alpha_3 ROA + \alpha_4 AGE + \alpha_5 WB_TOT + \alpha_6 E_INDEX + \alpha_7 CEO + COE$
+ $\alpha_8MGTOWN + \alpha_9ICW + \alpha_{10}RESTATE + \alpha_{11}IDIOSYN + \alpha_{12}ABSDACC + \alpha_{13}\#WB_ALLEG + \alpha_{12}MB_ALLEG$
$\alpha_{14}BLOCKOWN + \alpha_{15}BTM + \varepsilon$

Veriable		1 C	A11 C	A11 C	A11_C	Man Gammaint
variable	All firms	Non-financiai				
	(1)		(2)	(4)	(5)	firms only
Test and and	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	0.0149	0.5497	0.5285	0.0843	0.6081	0.5089
	(0.9221)	(0.0713)	(0.0849)	(0.1483)	(0.2024)	(0.3361)
LEV	-0.5913	-0.3843	-0.3644	-0.4958	-0.4753	-0.5427
	(0.1107)	(0.3232)	(0.3534)	(0.2227)	(0.2482)	(0.2357)
FCF	-0.1326	-0.1673	0.0013	-0.7069	-0.5049	-0.2156
	(0.8879)	(0.8659)	(0.9989)	(0.4961)	(0.6318)	(0.8488)
ROA	-0.2632	-0.0160	-0.1050	0.0811	-0.0091	-0.1499
	(0.7014)	(0.9827)	(0.8878)	(0.9169)	(0.9908)	(0.8525)
AGE	0.0042	0.0062	0.0050	0.0060	0.0047	0.0053
	(0.2458)	(0.1276)	(0.2204)	(0.1605)	(0.2781)	(0.2526)
WB_TOT		-0.1275		-0.1347		
		(0.0001)		(0.0001)		
WB_PE			-0.2177		-0.2280	-0.1822
			(0.0130)		(0.0109)	(0.0564)
WB_IR			-0.1975		-0.2125	-0.2154
			(0.0001)		(0.0001)	(0.0001)
WB_PROT			0.0256		0.0323	0.0383
			(0.6831)		(0.6133)	(0.5765)
E-INDEX		0.1798	0.1873	0.1927	0.2029	0.1804
		(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0004)
CEO = COB		0.3254	0.3612	0.3263	0.3625	0.3327
		(0.0208)	(0.0112)	(0.0238)	(0.0131)	(0.0319)
MGTOWN		0.1860	0.2553	0.3300	0.4065	0.3440
		(0.7077)	(0.6066)	(0.5336)	(0.4426)	(0.5466)
ICW				0.1382	0.1594	0.1920
				(0.4765)	(0.4134)	(0.3478)
RESTATE				0.0645	0.0556	0.0406
				(0.7248)	(0.7652)	(0.8394)
IDIOSYN				-0.0015	-0.0097	0.0333
				(0.9899)	(0.9337)	(0.7959)
ABSDACC						1.5883
						(0.1252)
# WB ALLEG				0.3663	0.4172	0.6026
				(0.0719)	(0.0421)	(0.0198)
BLOCKOWN				0.2624	0.3015	0.1981
				(0.5527)	(0.4982)	(0.6804)
BTM				-0.3452	-0.3368	-0.1693
				(0.0454)	(0.0514)	(0.4591)
N	376	376	376	376	376	328
Log likelihood	-258.75	-232.31	-228.82	-227.62	-223.63	-196.19
Pseudo R ²	1.0%	14.8%	16.5%	16.6%	18.6%	17.7%

The dependent variable, LOBBY, is a binary variable that equals one (zero) for lobbying (non-lobbying) firms. Leverage (LEV) is defined as long-term debt divided by total assets. FCF is operating cash flow less capital expenditures divided by total assets. ROA is defined as income before extraordinary items divided by total assets. AGE is the number of years the firm appears on Compustat. LEV, ROA and AGE are all measured at the end of 2009. We include four self-constructed measures for the strength of a firm's whistleblowing program, based on descriptions provided within each firm's Code of Ethics - program efficacy (WB PE), independence of reporting (WB IR), and protection provided to WBs (WB PROT). Overall WB strength (WB TOT) is computed as the sum of the three categories. Entrenchment index (E-INDEX), is measured as the sum of six indicator variables for corporate governance provisions: staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments. E-INDEX thus ranges from zero to six. CEO duality (CEO=COB) is an indicator variable that equals one if the firm combines the CEO and Chairman of the Board positions, and zero otherwise. Managerial stock ownership (MGTOWN) represents the percentage of stock owned by the top five executives of the firm. CEO=COB and MGTOWN are obtained from firms' 2009 proxy statements filed with the SEC. Internal Control Weakness (ICW) is as an indicator variable that equals one if the firm disclosed an internal control weakness in any quarter of fiscal 2005 through 2009, and zero otherwise. RESTATE as an indicator variable that equals one if the firms' financial statements contained a misstatement during fiscal 2005 through 2009, and zero otherwise. IDIOSYN is the firm's idiosyncratic stock return volatility for fiscal 2009, measured using firm-specific regressions of weekly stock returns on market and industry returns. We measure absolute value of discretionary accruals (ABSDACC) based on the Jones (1991) model for fiscal 2009. # WB_ALLEG, captures the number of times a firm has been named in a WB complaint by OSHA or the press, over the 2007-2009 period. BLOCKOWN, is defined as the percentage of stock owned by blockholders measured at the end of 2009. BTM is defined as the annual book value per share divided by price per share at the end of fiscal 2009. Pvalues (reported in parentheses) are based on two-tailed significance levels.

	III Excess I	UTTION	to Returns / Hound Event Dates R	Predicted	Lobbying	Control	
				Effect on	Lobbying	Eirma	Diff
Errent	Data	Т	Description	A dention	$\Gamma II IIIS$	$\Gamma II IIIS$	
Event	Date	Type	Description	Adoption	(N=182)	(N=182)	p-value
1	03/26/09	WB	SEC Chair to request new program	Positive	0.0180	0.0092	0.0125
			that compensates WBs		(0.0004)	(0.0505)	
2	05/07/09	WB	SEC Enforcement Director testifies	Positive	-0.0081	-0.0180	0.0055
			to Senate Banking Committee		(0.0654)	(0.0007)	
			regarding new WB program				
3	07/10/09	DF	Investor Protection Act introduced	Positive	-0.0051	-0.0099	0.1531
					(0.2102)	(0.0704)	
	07/14/09	WB	SEC officially requests WB program				
4	07/22/09	WB	SEC supports Investor Protection	Positive	0.0050	0.0013	0.1710
			Act		(0.1736)	(0.4093)	
5	09/10/09	WB	SEC Enforcement Director testifies	Positive	0.0059	0.0091	0.2101
			to Senate Banking Committee		(0.1344)	(0.0592)	
			regarding WB initiative				
6	12/09/09	WB	SEC Enforcement Director testifies	Positive	0.0030	0.0055	0.2939
			to Senate Judiciary Committee		(0.3199)	(0.2062)	
	12/11/09	DF	Dodd-Frank Act passes House				
7	01/14/10	WB	SEC Chair testifies to Financial	Positive	0.0044	0.0043	0.4886
			Crisis Inquiry Commission		(0.2059)	(0.2246)	
8	05/20/10	DF	Dodd-Frank Act passes Senate	Positive	-0.0049	-0.0009	0.1511
					(0.1771)	(0.4364)	
9	06/30/10	DF	Combined legislation passes House	Positive	-0.0073	-0.0069	0.4497
					(0.0854)	(0.1139)	
10	07/15/10	DF	Combined legislation passes Senate	Positive	0.0057	0.0061	0.4696
					(0.2105)	(0.2117)	
	07/20/10	WB	SEC Chair testifies to House				
			Financial Services Committee				
	07/21/10	DF	Dodd-Frank Act signed by President				
11	09/22/10	WB	SEC Enforcement Director testifies	Positive	0.0000	-0.0013	0.3682
			to Senate Judiciary Committee		(0.4986)	(0.4063)	
12	09/30/10	WB	SEC Chair testifies to Senate	Positive	-0.0031	-0.0044	0.4180
			Banking Committee		(0.2861)	(0.2448)	
13	11/03/10	WB	SEC releases proposed WB	Positive	-0.0046	-0.0030	0.3419
			provisions		(0.1930)	(0.2954)	
						0 0	
14	12/15/10	WB	Comment letters submitted to SEC	Positive	0.0082	0.0009	0.0282
					(0.0584)	(0.4374)	

 TABLE 4

 Mean Excess Portfolio Returns Around Event Dates Related to WB Provision Adoption

15	02/17/11	WB	SEC Chair testifies to Senate Banking Committee	Positive	0.0012 (0.4199)	-0.0004 (0.4762)	0.3589
16	03/10/11	WB	SEC officials testify to House Financial Services Committee on program implementation	Positive	0.0050 (0.2308)	-0.0028 (0.3480)	0.0589
	03/15/11	WB	SEC Chair testifies to House Financial Services Committee				
17	05/04/11	WB	SEC Chair testifies to Senate Financial Services Committee	Positive	0.0065 (0.1125)	0.0079 (0.0821)	0.3635
18	05/11/11	WB	House hearing on no internal reporting requirement	Negative	0.0039 (0.2341)	0.0051 (0.1851)	0.3816
19	05/25/11	WB	Final WB rules are adopted with slight modifications	Positive	-0.0038 (0.2402)	-0.0036 (0.2589)	0.4879
20	07/11/11	WB	Whistleblower Improvement Act of 2011 introduced to House	Negative	0.0003 (0.4767)	-0.0012 (0.4130)	0.3460
21	07/21/11	WB	SEC Chair testifies to Senate Banking Committee; no internal reporting requirement emphasized	Negative	-0.0068 (0.1034)	-0.0052 (0.1799)	0.3433
Combi	ned effect of	fEvents	1-21 (with events 18, 20, and 21 revers	e coded)	0.0268 (0.1499)	-0.0043 (0.4372)	0.0496
Combi 21 rev	ined effect of erse coded)	f all Wh	istle Blowing (WB) events (with events	18, 20, and	0.0395 (0.0524)	0.0038 (0.4414)	0.0221
Combi	ined effect of	f all Doc	ld-Frank (DF) events		-0.0109 (0.2263)	-0.0061 (0.3441)	0.3265
Combi	ned effect of	f all WB	events with confounding DF events ren	noved	0.0377 (0.0471)	0.0017 (0.4712)	0.0143
Combi (events	ined effect of s 13 and 19 r	f all WB everse c	events with confounding DF events ren oded)	noved	0.0487 (0.0160)	0.0149 (0.2660)	0.0211

This table presents mean excess portfolio returns around events related to adoption of the Dodd-Frank WB provisions. Type WB events relate directly to the creation of the whistleblowing provisions, and Type DF events relate to Dodd-Frank Reform Act legislative actions. Variance-weighted portfolio returns are measured over five-day (-1,+3) windows around each event date; event windows for events 3, 6, 10, and 16 begin one day before the earliest event and three days after the last. Excess portfolio returns, estimated using the Schipper and Thompson (1983) methodology over the period 3/1/2009 through 7/31/2011, equal the estimated coefficient for each event multiplied by the number of days in the event window. The portfolios consist of 182 lobbying firms that have complete daily return data over the entire event period and 182 non-lobbying control firms matched by industry and size. P-values are presented in parentheses and are based on one-tailed t-tests for the estimated coefficients of the lobbying and control firms and on F-tests for differences between the two portfolios, respectively.

TABLE 5 Mean Excess Portfolio Returns Around Event Dates Related to WB Provision Adoption, Conditional on Firm Characteristics

	Difference	Difference	Difference	Difference	Difference
	Low - High	Low - High	Low - High	Low- High	High – Low
	WB_TOT	WB_PE	WB_IR	WB_PROT	E-INDEX
Combined effect of Events 1-21 (with events 18, 20, and 21	0.0305	0.0267	0.0106	0.0175	0.0662
reverse coded)	(0.1130)	(0.1432)	(0.3551)	(0.2239)	(0.0772)
Combined effect of all Whistle Blowing (WB) events (with	0.0323	0.0282	0.0255	0.0216	0.0812
events 18, 20, and 21 reverse coded)	(0.0720)	(0.1109)	(0.1463)	(0.1231)	(0.0405)
Combined effect of all Dodd-Frank (DF) events	0.0080	0.0022	-0.0058	0.0064	-0.0176
	(0.4866)	(0.4513)	(0.3943)	(0.3682)	(0.2456)
Combined effect of all WB events with confounding DF events	0.0215	0.0245	0.0166	0.0111	0.0838
removed	(0.0464)	(0.0904)	(0.0392)	(0.1282)	(0.0187)

This table presents mean excess portfolio returns around events related to adoption of the Dodd-Frank WB provisions. Event dates are defined in Table 4. Excess portfolio returns, estimated using the Schipper and Thompson (1983) methodology over the period 3/1/2009 through 7/31/2011, equal the estimated coefficient for the event multiplied by the number of days in the event window. The portfolios consist of 182 firms that submitted comment letters to the SEC, split into Low and High groups based on median values of *WB_TOT*, *WB_PE*, *WB_IR*, *WB_PROT*, and *E-INDEX*, as defined in Table 2. P-values are based on F-tests for differences in mean excess portfolio returns.

				Predicted						
				Effect on	US Firms	US Firms	US Firms			
Event	Date	Туре	Description	Adoption	EWRET	VWRET	Lobby-Non			
1	03/26/09	WB	SEC Chair to request new program	Positive	0.0388	0.0313	0.0192			
			that compensates WBs		(0.0324)	(0.0801)	(0.0004)			
2	05/07/09	WB	SEC Enforcement Director testifies	Positive	-0.0054	-0.0235	0.0102			
			to Senate Banking Committee		(0.3988)	(0.1398)	(0.0343)			
			regarding new WB program							
3	07/10/09	DF	Investor Protection Act introduced	Positive	0.0146	0.0265	0.0031			
					(0.2792)	(0.1515)	(0.3215)			
	07/14/09	WB	SEC officially requests WB							
			program							
4	07/00/00	II ID		D	0.0000	0.0050	0.0050			
4	07/22/09	wВ	SEC supports Investor Protection	Positive	0.0086	0.0050	0.0053			
			Act		(0.3418)	(0.4001)	(0.1714)			
F	00/10/00	WD	SEC Enforcement Director to stiffing	Desitions	0.0209	0.0202	0.0076			
3	09/10/09	WD	to Sonato Donking Committee	Positive	(0.0298)	(0.0202)	(0.0070)			
			to Senate Banking Commutee		(0.0777)	(0.1737)	(0.0877)			
			regarding wB initiative							
6	12/00/00	WB	SEC Enforcement Director testifies	Positive	0.0051	0.0082	0.0037			
0	12/09/09	WD	to Senate Judiciary Committee	1 Osterve	(0.4193)	(0.3752)	(0.2879)			
			to Senate Fudienary Committee		(0.41)3)	(0.5752)	(0.2077)			
	12/11/09	DF	Dodd-Frank Act passes House							
	1_, 11, 0,	21								
7	01/14/10	WB	SEC Chair testifies to Financial	Positive	0.0223	0.0185	0.0062			
			Crisis Inquiry Commission		(0.1413)	(0.1977)	(0.1373)			
			1 2		× /	· /				
8	05/20/10	DF	Dodd-Frank Act passes Senate	Positive	-0.0100	-0.0006	-0.0047			
			-		(0.3173)	(0.4895)	(0.2014)			
9	06/30/10	DF	Combined legislation passes House	Positive	-0.0549	-0.0445	-0.0111			
					(0.0045)	(0.0203)	(0.0242)			
10	07/15/10	DF	Combined legislation passes	Positive	0.0038	0.0028	0.0059			
			Senate		(0.4460)	(0.4624)	(0.2189)			
	/ /									
	07/20/10	WB	SEC Chair testifies to House							
			Financial Services Committee							
	07/01/10	DE								
	07/21/10	DF	Dodd-Frank Act signed by							
			President							
11	00/22/10	WD	SEC Enforcement Director testifica	Docitivo	0.0114	0.0125	0.0011			
11	09/22/10	WB	to Senate Indicionary Committee	Positive	-0.0114	-0.0123	-0.0011			
			to Senate Judiciary Committee		(0.2939)	(0.2822)	(0.4190)			
12	09/30/10	WR	SEC Chair testifies to Senate	Positive	0.0026	0.0020	-0.0030			
14	57,50,10		Banking Committee	1 0510100	(0.4513)	(0.4640)	(0.2992)			
					(0.1010)	(0.1010)	(0.2))2)			

 TABLE 6

 Mean Excess Portfolio Returns Around Event Dates Related to WB Provision Adoption:

 U.S. versus non-U.S. firms

13	11/03/10	WB	SEC releases proposed WB provisions	Positive	0.0121 (0.2819)	0.0123 (0.2843)	-0.0037 (0.2561)
14	12/15/10	WB	Comment letters submitted to SEC	Positive	0.0115 (0.2916)	0.0114 (0.3050)	0.0095 (0.0464)
15	02/17/11	WB	SEC Chair testifies to Senate Banking Committee	Positive	-0.0201 (0.1899)	-0.0192 (0.2145)	-0.0005 (0.4707)
16	03/10/11	WB	SEC officials testify to House Financial Services Committee on program implementation	Positive	-0.0068 (0.3986)	-0.0017 (0.4613)	0.0050 (0.2402)
	03/15/11	WB	SEC Chair testifies to House Financial Services Committee				
17	05/04/11	WB	SEC Chair testifies to Senate Financial Services Committee	Positive	0.0128 (0.2724)	0.0140 (0.2601)	0.0079 (0.0797)
18	05/11/11	WB	House hearing on no internal reporting requirement	Negative	-0.0132 (0.2636)	-0.0097 (0.3269)	0.0031 (0.2890)
19	05/25/11	WB	Final WB rules are adopted with slight modifications	Positive	-0.0051 (0.4050)	-0.0049 (0.4107)	-0.0043 (0.2191)
20	07/11/11	WB	Whistleblower Improvement Act of 2011 introduced to House	Negative	-0.0107 (0.3038)	-0.0157 (0.2356)	-0.0009 (0.4385)
21	07/21/11	WB	SEC Chair testifies to Senate Banking Committee; no internal reporting requirement emphasized	Negative	-0.0299 (0.0772)	-0.0236 (0.1382)	-0.0089 (0.0563)
Combined effect of Events 1-21 (with events 18, 20, and 21 reverse coded)						0.1176 (0.1389)	0.0360 (0.1052)
Combined effect of all Whistle Blowing (WB) events (with events 18, 20, and 21 reverse coded)					0.1701 (0.0301)	0.1707 (0.0529)	0.0536 (0.0245)
Combined effect of all Dodd-Frank (DF) events					-0.0396 (0.2139)	-0.0069 (0.4517)	-0.0116 (0.2268)
Combined effect of all WB events with confounding DF events removed				0.1591 (0.0360)	0.1245 (0.0896)	0.0476 (0.0274)	

This table presents mean excess portfolio returns around events related to adoption of the Dodd-Frank WB provisions for U.S. firms, relative to the MSCI World Index (excluding U.S. firms). Type WB events relate directly to the creation of the whistleblowing provisions, and Type DF events relate to Dodd-Frank Reform Act legislative actions. Excess portfolio returns, estimated using the Schipper and Thompson (1983) methodology over the period 3/1/2009 through 7/31/2011, equal the estimated coefficient for each event multiplied by the number of days in the event window. The portfolios consist of 182 lobbying firms that have complete daily return data over the entire event period and 182 non-lobbying control firms matched by industry and size. P-values are presented in parentheses and are based on one-tailed t-tests for the estimated coefficients of the lobbying and control firms and on F-tests for differences between the two portfolios, respectively.