Negation of Sanctions: The Personal Effect of Political Contributions[*]

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Abstract

We show that political contributions negatively affect the severity of governmental enforcement outcomes for executives accused of committing fraud. Contributing executives receive smaller monetary fines, are banned fewer years as an officer or director of a public company, serve less time in prison or on probation, and enjoy a lower probability of receiving the harshest penalty from both the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ). When exploring potential channels, we find that political contributions lengthen the case time-to-resolution with the SEC and increase the chance of settling with government agencies instead of going to court, allowing fraudulent executives to receive less harsh sanctions. Finally, political contributions appear to facilitate a shift in penalties from the fraudulent executive to shareholders. By documenting the personal benefits that executives can extract from political connections, our paper identifies a mechanism that potentially undermines the disciplining effect for fraudulent managers.

JEL classification: G3; K4
Key Words: Political contributions; SEC enforcement; DOJ enforcement; fraud

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1. Introduction

On November 27, 2006, Sanjay Kumar, former CEO of Computer Associates, was sentenced to 12 years in prison and 3 years of probation for his role in an accounting fraud of approximately $3.3 billion at Computer Associates spanning the period of 1998-2000. Kumar later also agreed to pay $798.6 million in restitution. Computer Associates had made no political contributions during the period of the fraud.

Approximately five months later, Joseph Nacchio, former CEO of Qwest Communications, was convicted in April 2007 of accounting fraud in connection with the Denver-based company's 1999-2001 $3.57 billion accounting scandal. Nacchio was sentenced to 6 years in prison, ordered to pay $63.4 million in fines and restitution. During the fraud period, Qwest's Political Act Committee (PAC) contributed an average of $134,216 each year. Nacchio himself also made substantial individual contributions.[1]

The existing literature has documented the real effects of political contributions at the firm level. However, we know little about how individuals can be affected by political connections. Yet the above anecdotes suggest that the impact of political contributions may go beyond firms, extending even to corporate executives. In this paper, we focus on the personal benefits of political contributions, investigating to what extent executives' political connections, initiated and sustained through their companies' and their own political contributions, affect the severity of government penalties when they are charged with fraud.

We collect information on political contributions and manually assemble a novel data on penalties imposed by government agencies for executives accused of engaging in fraudulent

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[1] For details, see SEC Litigation Release No. 20082 (April 19, 2007) and No. 21825 (January 25, 2011) respectively. Information on political contributions comes from the Federal Election Commission.

activities. We explore two dimensions of government sanctions: civil penalties imposed by the Securities and Exchange Commission (SEC) in terms of monetary fines and officer bans, and criminal penalties imposed by the Department of Justice (DOJ) in terms of probation and prison sentences.

We document a negative relationship between political contributions and the severity of government enforcement. A $10,000 increase in annual political contributions made by a fraudulent executive, individually and via his firm's political campaign contributions, is associated with a $34,985 reduction in monetary penalty and 0.16 fewer years in an officer ban. Given that an average fraudulent executive in our sample earns $7,466,232 per year, being banned for 0.16 fewer years translates into a saving of over $1.2 million from lost compensation. Each additional $10,000 contribution also leads to 0.334 fewer years of probation, 0.226 fewer years of prison, as well as a 17.26% reduction in the probability that he will receive both an officer ban and prison time—the harshest penalties from both government agencies.

While the baseline results are consistent with the idea that fraudulent executives who make more political contributions face less severe penalties from government agencies, an important concern is that the decision to contribute is endogenous. As such, unobserved factors correlated with both the extent of political contributions and the severity of government sanctions may bias the results. We perform a series of tests to mitigate concerns about endogeneity. First, all results are obtained by controlling for fraud type-, settlement year-, and industry-fixed effects. Thus, our findings cannot be interpreted as being driven by the nature of the fraud, or by time and industry shocks.

Second, we construct instrumental variables (IVs) for the amount of political contributions and undertake a two-stage least squares (2SLS) analysis. Alternatively, we address the potential

endogeneity in political contributions using a two-step Heckman procedure. Both the 2SLS analysis and Heckman procedure continue to suggest a negative effect of political contributions on the severity of both civil and criminal penalties.

Third, we explore whether alternative economic causes can explain the disparities in government penalties between fraudulent executives who make generous contributions and those who do not. Specifically, the "benefit exceeding harm" hypothesis postulates that when assessing the penalties, the SEC and/or DOJ may take the net effect of the work of an accused executive into consideration if he has otherwise managed the firm well and increased shareholder wealth. The "earned leniency" argument suggests that if a firm has generally exercised good governance and put its best efforts forth to comply with SEC regulations, this compliance may earn that firm (as well as its executives) leniency for any wrongdoing. The "alternative disciplining mechanisms" hypothesis takes into account the fact that there exist many types of potential penalties for misconducts, all of which are substitutes or complements to unknown extents. Thus, this hypothesis proposes that a government agency may impose less severe penalties where the accused executive has already been penalized by the firm or the market.

We find that the impact of political contributions on reduced government sanctions remains statistically and economically significant after controlling for these alternative hypotheses and discipline mechanisms. Thus, the net benefits accrued to shareholders, earned leniency, and alternative sanctions such as termination by the board, class action lawsuits, and firm delisting, do not fully explain the results.

To further corroborate the causal interpretation of our results, we explore two channels through which political contributions may generate reduced government sanctions for fraudulent executives. We collect data on how the cases are resolved and distinguish between cases that result

in a court judgment and those that are resolved through a settlement with the SEC and/or a plea bargain with the DOJ. Penalties determined by courts are usually significantly harsher. For instance, executives in our sample face $8.85 million more in monetary penalty and 3.28 more years in prison if penalties are imposed by the court. *Ceteris paribus*, they would prefer that the penalties be imposed by government agencies rather than by the court. Indeed, we find that political contributions allow fraudulent executives to receive more lenient sanctions by settling with the SEC and/or reaching a plea bargain with the DOJ, instead of going to court.

Katz (2010) points out that within the SEC, enforcement actions that take longer to resolve are often closed with no resulting penalties, particularly when a new attorney is assigned the case or a new SEC Commissioner is appointed. This implies that if a fraudulent executive can delay resolution of the case long enough, he could potentially also reduce the severity of the penalty imposed by the SEC. We find that political contributions help lengthen the case time-to-resolution, allowing for less severe civil penalties.

Finally, we provide evidence that political contributions facilitate a transfer of penalty from fraudulent managers to shareholders. As the severity of government sanctions on individual executives declines, penalties accrued to the firm that suffers from their fraudulent activities increases. More importantly, the extent of shifting the fraud consequence to shareholders is exacerbated in the presence of more substantial political contributions.

Our paper contributes to the large literature studying the real impacts of political connections and contributions. On the one hand, political contributions and connections benefit shareholders in a variety of countries in terms of higher market values (Fisman 2001; Faccio 2006; Jayachandran 2006; Claessens, Feijen and Laeven 2008; Cooper, Gulen and Ovtchinnikov 2010), more government contracts (Goldman, Rocholl and So 2013), and a higher likelihood of

government bailouts (Faccio, Masulis and McConnell 2006). On the other hand, political connections can entail social costs (Fisman and Wang 2015) and pose challenges for corporate governance (Dahan, Hadani and Schuler 2013). In particular, political spending allows firms to deter fraud detection (Yu and Yu 2011) and reduces the probability that the firm is involved in SEC enforcement and the monetary penalties it received from the SEC (Correia 2014).

This strand of literature mostly focuses on how political contributions benefit or harm the firm. To the best of our knowledge, our paper is the first to explore how executives use political connections for *personal* benefit. Examining penalties at the individual level allows us to explore how political spending affects penalty transfer between fraudulent mangers and shareholders, who have already suffered damages from the fraud. Our paper thus complements Correia (2014) by providing novel evidence that political contributions can skew the enforcement process in ways that benefit managers, allowing executives to shift the consequences of the fraud away from themselves, even if that means shifting the consequences to the shareholders.

Our findings shed light on the extent to which political spending influences the government enforcement process above and beyond fraud detection, suggesting that penalties are not optimal and that the effect of political contributions on corporate governance may have been previously under-estimated. In light of Karpoff, Lee and Martin (2008), who show that managers responsible for corporate financial fraud suffer negative career and monetary consequences, we identify a mechanism that can potentially undermine the disciplining effect for fraudulent managers and potentially exacerbate an executive's ex-ante incentive to commit fraud.

Our paper also contributes to the literature on corporate fraud (see Yu 2013 for a survey). A strand of this literature investigates the effectiveness of mechanisms—including government agencies—that are designed to detect fraud (e.g., Dyck, Morse and Zingales 2010; Kedia and

Rajgopal 2011; Yu and Yu 2011; Correia 2014). Instead of the efficiency of government agencies in detecting fraud, we focus on how political contributions affect their ability to regulate and discipline after the fraud is discovered.

The rest of the paper is organized as follows. Section 2 introduces the methodology and Section 3 describes the data. Sections 4 and 5 present the empirical results. Section 6 concludes. Variable definitions are in the Appendix.

2. Methodology

2.1 Measuring the Severity of Government Enforcement

Following a "trigger event" and a formal investigation, the SEC files a complaint against named defendants. After an investigation, the SEC either drops the case or continues with administrative, civil, and/or criminal litigation proceedings. In the case of potential criminal behavior, it may be referred to the Department of Justice. Put differently, once an executive is found liable for fraud, the government can impose civil penalties, criminal penalties, or both.

When an action is resolved, the SEC may impose a monetary penalty, which consists of civil penalties and fines, disgorgement of illicit profits, and sanctions. Our first proxy for civil penalties is thus "Monetary Penalty", calculated as the natural logarithm of one plus the total dollar amount of monetary penalties imposed on an accused executive.

Alternatively, we scale monetary penalties by the total compensation that the executive receives at the beginning of the fraudulent period. The total compensation is the sum of the executive's salary, bonus, other annual, total value of restricted stock granted, total value of stock options granted (computed using Black-Scholes), long-term incentive payouts, and all other total. Not only does executive compensation affect the severity of fraud (Peng and Roell 2014), but more

importantly, the variable "Monetary Penalty/Compensation" captures the degree of monetary damage to a fraudulent executive's personal wealth. In many ways, this measure is more relevant to the severity of the penalty, as one would expect that a $100,000 monetary penalty, which is approximately the median monetary penalty in our base sample, would be felt less by a CEO earning $6 million per year than a Vice President earning $250,000 per year. More importantly, since political contributions lead to higher firm value (Fisman 2001; Faccio 2006), the amount of monetary penalty may be marginal or negligible if the wealth of the accused executive has increased dramatically during the fraudulent period.

The SEC can also ban the executive from serving as an officer or director at a public company. Being banned as an officer prevents an individual from serving in a top managerial role, representing a significant economic penalty in the form of reduced lifetime earnings. The longer the ban period, the greater the potential compensation loss accrued to an individual.

We use "Officer Ban" to capture the severity of such a ban, calculated as the natural logarithm of one plus the number of years the fraudulent executive is banned as an officer or director of a publicly listed company. This variable is set to zero if no officer ban is imposed. In cases where an executive receives a permanent officer ban, we determine the effective length of the ban by estimating the number of the years the executive could have served as an officer, had the ban not been imposed. Specifically, the length of the effective ban is computed as the difference between retirement age and the executive's age at the time the permanent ban was imposed.[2]

In terms of criminal penalties, an accused executive can receive probation and/or a prison sentence. We compute "Probation" as the natural logarithm of one plus the number of years (or

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[2] In our main analysis, we use 78 as the cut-off for retirement age. Some, but not all, of firms may have mandatory retirement ages ranging from 72 to 75 for directors. Results are robust to using 72 or 75 to calculate the length of the effective ban.

fraction thereof) of probation the executive received, and "Prison" as the natural logarithm of one plus the number of years (or fraction thereof) of prison time the executive received. These variables are set to zero when no probation or prison term is involved. Note that an individual may receive probation instead prison, or receive a prison sentence only. In some cases, an accused executive receives both probation and prison terms. For this reason, we examine probation and prison separately in our main analysis. In Section 4, when we rank the overall severity of penalty, we consider probation as a potential substitute sentence for prison.

Lastly, we capture the probability of receiving the most severe penalty with "Prison & Ban". This dummy variable equals to one if an accused executive receives both the most severe civil penalty from the SEC and the most severe criminal penalty from the DOJ, and zero otherwise.

2.2 Measuring Political Contributions

We aim to assess the overall impact of an executive's political connection on government enforcement. In reality, however, an executive can channel contributions to a politician via his firm's PACs, as well as contribute directly as an individual. We thus calculate the average annual contribution (in $10,000s) made by an accused executive and his firm (via PAC) during the fraudulent period. To account for the skewness of the amount of political contributions, we define "Political Contributions" as the natural logarithm of one plus this value. This variable is set to zero for those that do not contribute.

By aggregating major contribution channels, this variable captures the cumulative effect of corporate executives spending on building and maintaining political connections. This is because, while personal contributions may suggest a more aggressive and clear preference of the contributor, it is limited by a lower cap compared to a firm's PACs thus may understate the contribution effort.

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[3] By contrast, PACs not only allow an executive to shift the cost of spending on political contributions to shareholders, but also offer the anonymity for the contributors, which is more relevant to our research question. Furthermore, Babenko, Fedaseyeu and Zhang (2017) provide causal evidence that employees contribute significantly more money to political candidates supported by CEO, suggesting that PAC contributions are likely an extension of contributions from top management of the firm.

2.3 Empirical Framework

We explore the link between political contributions and the severity of government sanctions. Our main tests are based on the following empirical model:

$$Penalty = \beta_0 + \beta_1(Political\ Contributions) + \Omega'Z + \delta_F + \delta_E + \delta_I + \delta_Y + \varepsilon$$

The dependent variable is one of the penalty measures described in Section 2.1. The key explanatory variable is "Political Contributions". We control for a vector of time-varying fraud and firm characteristics, Z, which may affect the extent of enforcement. For instance, the size and severity of the fraud are positively linked to legal and monetary penalties (Karpoff, Lee and Martin 2007). We measure the severity of fraud by "Damages", computed as the natural logarithm of the amount of damages assessed by the SEC, which is the total loss to the firm (or shareholders) as a result of the fraud, independent of whether the fraud was determined to be criminal or civil. [4]

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[3] Corporations are prohibited from making direct political contributions in federal elections but may contribute indirectly either through contributions to PACs or contributions of its officers. PAC contributions are limited in two ways: individuals cannot contribute more than $5,000 to a single PAC in any given year, and PACs may not contribute more than $5,000 to any particular candidate in a given election cycle. The Bipartisan Campaign Reform Act of 2002 (BCRA) limited "soft money" contributions to federal parties and indexed contribution limits for inflation, increasing it from $1,000 to $2,000. The limit for individual contributions per candidate was further increased to $2,500 for the 2011-2012 election cycle, while the PAC limit has remained at $5,000. For the purpose of campaign contribution limits, the primary election and general election are considered separate election cycles.

[4] The SEC assess damages from six types of fraud: earnings fraud, securities fraud, option backdating, bribery, insider trading, and embezzlement. In the case of earnings fraud or options backdating, the damage is the amount that the firm misreported on its financial statements. In the case of securities fraud, the amount of shareholder loss. In the case of FCPA bribery, the amount of the bribes paid. In the case of embezzlement or insider trading, the amount of personal gain to the executive.

Executives can be accused of more than one type of fraud. In this case, the amount is the cumulative effect of the fraud(s). Hence, it is not necessarily a summation of the damages from each fraud type, but rather the net effect of the multiple fraud types (allowing for overlapping damages).

Damages can be more significant when a fraud lasts for a longer period of time (Yu and Yu, 2011), resulting more severe penalties. We thus control for the duration of the fraud, calculated as the number of years from the initiation of the fraud to its conclusion. Finally, we include the number of accused executives in the fraud, as misconduct is more likely and more complex in groups than individually (Kocher, Schudy and Spantig 2017).

The severity of the penalties that an accused executive receives may be affected by the nature of the fraud itself. For instance, the SEC might have more authority to impose sanctions for some types of fraud than others, and/or certain natures of fraud are more destructive than others. For this reason, in all regressions we include fraud type fixed effects (δ_F).[5]

To account for the possibility that executives working for a large firm can use its "deep pockets" to fend off charges, pay for civil penalties, and hire superior legal counsel, we control for firm size, calculated as the natural logarithm of the firm's average market cap during the fraudulent period. Following Kedia and Rajgopal (2011), we also include a dummy for small firm to capture the potential non-linear effect of firm size in affecting the extent of government investigation and enforcement; a firm is considered small if its total assets at the beginning of the fraudulent period are less than $200 million.

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[5] The fraud type dummies include the six types of fraud identified by the SEC as well as earnings restatement, which sets to one if a firm issued a formal earnings restatement in connection with the fraud. While there is an overlap between the earnings fraud from the AAERs and the earnings restatement from the Audit Analytic, these two are not identical. Many (but not all) of the investigations for earnings fraud were triggered by the firm's restatement, while some firms issued a restatement as a result of the SEC action. Put differently, not all restatements trigger an SEC investigation, and not all investigations resulted in a restatement.

The role of the executive may also influence penalties. CEOs or CFOs could be held more responsible than those in other roles. Collusion in the executive suite heightens the risk of corporate fraud (Khanna, Kim and Lu 2015). In the case of Qwest, in addition to CEO Joseph Naccio, four other executives were incarcerated and six were acquitted. In the case of Computer Associates, seven other executives besides Sanjay Kumar were sanctioned. Since the complexity of fraud and collusion among executives may affect to what extent the SEC/DOJ assess and impose penalties on individual officers, we include executive role fixed effects (δ_E) and control for the number of officers from the same firm that are investigated for the same matter.

Lastly, we consider the impact from regulatory and enforcement environments. The 2002 Sarbanes-Oxley Act (SOX) imposed greater criminal penalties for financial fraud, created new types of financial fraud, and increased the personal exposure of top executives to liability for financial misrepresentation. The head of the government agencies (Commissioner for the SEC or Attorney General for the DOJ), which, unlike the Supreme Court, is appointed by incoming presidents,[6] can play a role in determining the severity of the penalties. For instance, a government official picked by a Republican president may exhibit a different degree of "friendliness" towards corporations and leniency when assessing penalties than those selected by a Democratic president.[7] A legislator's influence on the agencies, hence the effectiveness of political contributions to the legislator's campaigns, is then affected by whether he or she is a member of the same party as the president who appoints the chiefs of the agencies. A firm's lobbying activities can also affect

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[6] The SEC is slightly different from the DOJ in that appointments occur in June and are somewhat more flexible. According to its website, "The Securities and Exchange Commission has five Commissioners who are appointed by the President of the United States with the advice and consent of the Senate. Their terms last five years and are staggered so that one Commissioner's term ends on June 5 of each year. The Chairman and Commissioners may continue to serve approximately 18 months after terms expire if they are not replaced before then. To ensure that the Commission remains non-partisan, no more than three Commissioners may belong to the same political party. The President also designates one of the Commissioners as Chairman, the SEC's top executive."

[7] "Bush S.E.C. Pick Is Seen as Friend to Corporations", June 3, 2005, The New York Times.

legislation, potentially influencing the extent of imposed penalties. Therefore, we include a dummy set to one if the penalty is imposed after July 30, 2002—the enactment of SOX ("SOX"), a dummy for whether the case is resolved at the time the heads of the agencies were appointed by a Republican Party president ("Republican-appointed Chief"), and a dummy for whether or not a firm engages in lobbying activities ("Lobby"). To further account for the fact that a penalty is affected by time-specific and industry-specific unobserved characteristics, we include settlement year fixed effects (δ_Y) and industry fixed effects (δ_I,).

2.4 Identification

The decision to make a political contribution is likely endogenous. We address the issue of causality using an instrumental variable (IV) framework. Alternatively, we also estimate our baseline tests using, respectively, a two-step Heckman model and the Abadie-Imbens (2006) matching approach.

An ideal instrument would be strongly correlated with political contributions but not directly influence the extent that government agencies impose penalties on fraudulent executives. We construct two instrumental variables for political contributions. Our first instrument exploits plausibly exogenous variation in political contributions due to the voting behaviors of legislators in alignment with the political orientation of corporate executives. This instrument is motivated by the literature documenting that campaign contributions are highly responsive to legislative candidates' ideologies (Wright 1985; Poole, Romer, and Rosenthal 1987) and voting behaviors (Conley and McCabe 2012) and in particular, that politically conservative individuals or institutions contribute to parties sharing the same core conservative political ideology (Hong and Kostovetsky 2012; Hutton, Jiang and Kumar 2015; Jiang, Kumar and Law 2016).[8] Since political

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[8] There is a large literature documenting the differences between conservative and liberal values. This difference is also reflected in the partisan differences between Democrats and Republicans. The existing literature finds that

conservativeness is partially explained by an individual's income, age, gender, race, education and religion (Campbell et al. 1960; Levitt 1996), contributions by corporate executives and their firms can be correlated with the conservative votes by politicians.

The empirical challenge to identify the conservativeness in the Congressional voting behaviors is that many existing proxies, such as a politician's self-claimed ideologies and party affiliation, can be used to cater political contributions. More importantly, they also likely affect how government agencies assess the penalties, potentially violating the exclusion restriction. Instead, we follow Washington (2008) and extract the conservative leaning in a legislator's voting behavior that stems from his or her offspring gender mix.

Washington (2008) provides persuasive evidence that the congresspersons with female children tend to vote more liberally on a range of issues, such as flexibility for working families, tax-free education, and productive rights. In a broader sample, Oswald and Powdthavee (2010) show that having daughters leads people to be more likely to vote for left-wing politician parties, whereas parenting sons seems to make people more likely to vote for right-wing parties.[9] Put differently, the offspring gender mix affects the extent to which a legislator attracts political contributions, but is unlikely the factor considered by the SEC or DOJ when assessing penalties on accused executives for their fraud.

Our first instrument, "Daughters", is thus the average number of politicians in the state where the fraudulent executives' firm is headquartered that have daughters during the fraudulent period, scaled by the average number of senate and congressional seats during the same period.

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political preferences of market participants influence their economic decisions and that contributions to the Democratic Party reflect contributors' being more aligned with liberal values, while contributors to the Republican Party are more aligned with conservative values (e.g., Hong and Kostovetsky 2012; Di Giuli and Kostovetsky 2014; Hutton, Jiang and Kumar 2015; Jiang, Kumar and Law 2016).

[9] An emerging literature has leveraged the natural experiment of a child's gender to a broader range of issues such as the effect of parenting daughters on the votes of judges (Glynn and Sen 2015) and on corporate investments that are aligned with liberal value such as corporate social responsibility (Cronqvist and Yu 2016).

By construction, this variable measures the extent of political ideology among local politicians (in this case, the liberal leaning in their voting behaviors) that affects contributions from local firms and individuals.[10] Consequently, it should affect the severity of government sanctions only through its effects on political contributions.

Our second instrument relates to a firm's past political contribution activities. "Prior Contribution" is a dummy variable if the firm has made political contributions 15 years prior to the beginning of the fraud. The intuition is straightforward. Political contributions tend to persist over time (Yu and Yu 2011). While a firm's past political contributions are correlated with its current contributions, they are observed years before any lawsuit and the subsequent government penalties. As such, they are unlikely to directly affect the varying degrees of sanctions imposed on executives that more than likely were not in their positions many years before the beginning of the fraud (Kaplan and Minton 2008).

3. Sample and Data

3.1 Government Enforcement

The SEC publicly discloses the Accounting and Auditing Enforcement Releases (AAERs), which are the copies of court documents or summaries of court rulings on actions instituted against a firm and/or individuals by the SEC, or notices of settlement or court rulings. We manually screen over 2,000 AAERs for civil actions initiated against executives of public companies during the period of January 1999 to December 2010.[11] Since our sample is at the executive level, we are

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[10] While the family structure (i.e., parenting a daughter) is identified at the individual politician's level, the implications of the variable generalize easily to the state level. For example, if liberal (conservative) executives are less likely to contribute to a given conservative (liberal) politicians due to different ideologies, the executives would likewise be less likely to contribute to all conservative (liberal) politicians.

[11] An "executive" can be the Chief Executive Officer (CEO), Chief Financial Officer (CFO), Chief Operations Officer (COO), Chief Information Officer (CIO), Chief Accounting Officer (CAO), Director, Controller, Treasurer, President, Vice President, General Counsel, or Chairman of the Board.

careful to avoid any duplications across releases. Our initial manual screening yields 572 accused executives from 238 firms. We exclude 69 executives in which the SEC enforcement actions have not been resolved by December 31, 2010, [12] and 51 executives that have missing firm-level information in Compustat. Our final sample includes 452 executives from 194 firms. Of these executives, 79 are CEOs and 144 are CFOs.

For these 452 executives, we collect information from the AAERs on fraud duration, the amount of damages assessed by the government agencies, the dates the action was filed and finalized, how the case was resolved, and fraud type. Earnings restatements are from the Audit Analytic. The AAER period of 1999 to 2010 corresponds to the date in which the actions are commenced or resolved. Since it often takes years to detect fraud and additional time to reach a final resolution once the fraud has been detected, the period in which executives commit fraud ranges from 1991 to 2007.

Information on civil penalties is from the AAERs. Obtaining data on criminal penalties, on the other hand, is less straightforward. This because the DOJ is comprised of 94 individual districts ("Offices of the United States Attorneys"), each with its own case load. Unlike the AAER database, there is no central database that lists all actions taken by the DOJ. Also unlike the AAERs, which issue a press release whenever the SEC files an action against a firm or an individual, only the most significant financial fraud cases are reported on the individual district websites.

To avoid the selection bias in that only the most publicized cases are reported, we proceed as follows: we start with our sample of executives accused by the SEC and see whether the DOJ also pursued criminal charges against these executives. Since the SEC only has authority to bring civil actions, the AAERs focus on civil penalties. Nevertheless, the AAERs often contain

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[12] Though all of the civil charges in our sample are resolved, there may be outstanding criminal charges with the DOJ. Criminal charges and penalties are current as of March 6, 2014.

information relating to pending criminal litigation or criminal sanctions against the executive. We then cross-reference our list of executives to determine criminal penalties with the individual websites of the 94 Offices of the United States Attorneys, the Corporate Counsel Fraud Database, and the Corporate Fraud Task Force Reports. We also perform a Lexis-Nexis and Google search of all executives in our sample. Doing so ensures that we have not missed anything from the AAER, if it was not included in the release. An example of this would be if only one type of fraud were mentioned in the AAER when multiple types were involved. We identify 142 that were charged by the DOJ. Of these, we were able to obtain the specifics of criminal outcomes for 138 charged executives.

3.2 Political Contributions and Politician's Family Structure

We manually collected data on PAC contributions between 2005 and 2007 from the detailed committee and candidate summary contribution files of the Federal Election Commission (FEC). PAC contribution data from 1991 to 2004 comes from Cooper, Gulen, and Ovtchinnikov (2010). We also manually collected individual executive contributions for the entire sample term from the Center for Responsive Politics.

To determine a politician's family structure, we merge Washington's (2008) data on children's information of the Congressional members between 1997 and 2004 (the 105th-108th Congress) with our sample of 2,012 politicians who have received political contributions from executives. We are able to identify the children and their gender of 585 legislators. For the remaining 1,427 politicians, we manually collect their children's information, including names and years of birth (if provided) from the Congressional Directories.

A legislator's family structure may change during the course of his/her political career, especially if the politician is repeatedly re-elected. For this reason, we track each politician's

biographies through the entire 101st through 111th Congressional Directory, whenever available. In cases where the names of the children are ambiguous with regard to gender or where only the number of children is available, we search Wikipedia, nndb.com, votesmart.org, OpenSecrets.org, and/or Sunlight Foundation online. We also identify children's gender information by searching obituaries, wedding announcements, special-focused interviews and news articles, social media, and family holiday photos. If a child's name remains ambiguous, we search babycenter.com, thinkbabynames.com, and babynameworld.com for gender origins. In cases where these websites provide contradicting information, we verify by cross-referencing at least another independent web source. Lastly, we manually crosscheck and update the children's information based on the Washington's (2008) dataset.

3.3 Other Data Sources

Firm financial information comes from Compustat. The total compensation of the executive is TDC1 from Execucomp (i.e., the sum of the executive's salary, bonus, other annual, total value of restricted stock granted, total value of stock options granted, long-term incentive payouts, and all other total), measured at the beginning of the fraudulent period. For executives from non-S&P 1500 firms, whose compensation is not available at Execucomp, we manually search the proxy statement (DEF 14A) in SEC EDGAR using Execucomp's definition of TDC1. Many of the executives in our sample are not in the five highest compensated executives, and thus their compensation is not required to be disclosed. As a result, we are only able to compute total compensation for 192 of our 452 executives.

3.4 Descriptive Statistics

Figure 1 displays the timeline from the initiation of the fraud to the resolution for our sample. An average fraud lasts for 3.4 years. The SEC enforcement period on average lasts about

3.35 years, followed by another 1.3 years to reach the final resolution.

Panel A of Table 1 reports the descriptive statistics for fraudulent executives. Thirty-five percent of our sample executives make political contributions. The annual contribution across candidates and election averages $15,406 per year during the fraudulent period. However, among those who contribute, the average annual political contribution is approximately $43,523, which is comparable to that reported in the existing studies (e.g., Ansolabehere, Snyder and Tripathi 2002; Cooper, Gulen and Ovtchinnikov 2010). The assessed total harm to the firm and its shareholders brought by an accused executive averages around $500 million. There is also evidence about the collusion inside the executive suites: on average, 3.68 executives in the same firm of the fraudulent executive were also accused for fraud.

Panel B shows a breakdown of the number of executives by fraud type. Note that an individual may be accused for more than one type of fraud. Earnings fraud is the most common type of fraud; with 91% of the 452 executives accused of manipulating earnings or revenue. The next most frequent type of fraud is securities fraud, accounting for 16.4% of the accused executives. It is also evident that a great majority of frauds occur within the executive suite.

4. Main Results

4.1 Political Contributions and the Severity of Penalties

Table 2 reports the main regression results. The unit of analysis is at the executive level. Robust standard errors are clustered around the role of executive.[13] Columns 1-3 and columns 4-5 present the regression estimates with respect to civil penalties imposed by the SEC and criminal

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[13] The role of executives follows the categories listed in Panel B of Table 1. Our results are robust if standard errors are clustered at the firm level.

penalties by the DOJ, respectively. Since the dependent variables contain a nontrivial fraction of zero values, we estimate tobit regressions and report the marginal effects (Wooldridge 2012).

Columns 1-3 reveal that "Political Contributions" is negatively related to the magnitude of all three proxies for the civil penalties, and is statistically significant at least at the 5% level. Controlling for firm-specific, fraud-specific, and executive characteristics, as well as the legal and regulatory environment at the time when sanctions are imposed, and unobserved industry-, fraud-, executive-, and year-specific factors that may affect the severity of civil penalty, larger political contributions are associated with a reduced monetary penalty and fewer years being banned as an officer or director.

These effects are not only statistically significant, but also economically sizable. For instance, column 1 of Table 2 indicates that a $10,000 increase in political contributions from the sample mean is associated with a $34,985 reduction in monetary penalty. The same increase is associated with a 0.16 of a year reduction in officer ban (column 3). Based on the sample average of our executive compensation ($7,466,232), this translates into approximately $1.2 million reduction in lost wages.

In terms of criminal penalties imposed by the DOJ, columns 4 and 5 show that the amount of political contributions made by an accused executive is significantly negatively correlated with the number of years of probation and/or prison he receives, and the probability of receiving the most severe sanctions. A $10,000 increase in political contributions from the sample mean is associated with a reduction in prison of close to a quarter of a year (0.226), which accounts for 11% of the sample mean of prison terms (2 years).

Lastly, in column 6, we estimate a probit model to examine the likelihood when an accused executive receives both the most severe civil penalty—officer ban—and the most severe criminal

penalty—prison term. A $10,000 increase in political contributions from the sample mean is associated with a 17.26% reduction in the probability that both agencies impose the most severe penalty.

4.2 Endogeneity of Political Contributions

4.2.1 IV Analysis

Table 2 reveals that fraudulent executives spending more on political contributions receive more lenient government sanctions. The ability to control for different sets of fixed effects allows us to exclude a wide-range of alternative explanations related to fraud-specific and executive-specific characteristics, as well as industry and time-specific shocks. To further address the concern for endogeneity in political contributions, as described in Section 2.4, we construct instruments for political contributions and undertake a two-stage least squares (2SLS) analysis.

Table 3 presents the 2SLS regression estimates, in which the amount of political contributions is instrumented with variables involving politicians' offspring ("Daughters") and previous contribution behaviors ("Prior Contributions"). Column 1 reports the first stage regression estimates. Existing literature has established that PACs reward political candidates that vote in line with the positions of the PAC (Conley and McCabe 2012) and that being a conservative is partially explained by individual characteristics including income, age, gender, education, and race (Campbell et al. 1960 and Levitt 1996). This indicates that local politicians with less liberal voting patterns are likely to attract more contributions from these executives and their firms. Consistent with the intuition behind this instrument, the coefficient estimate of "Daughters" is negative and significant at the 1% level. Also consistent with the literature that political contributions tend to persist over time, the coefficient estimate of "Prior Contributions" is positively and significantly related to the current amount of political contributions.

Columns 2 through 7 report the second-stage regression estimates, with the executives'

civil and criminal penalties as the dependent variable. The coefficient estimates of instrumented

"Political Contributions" are negative for all measures of penalties, suggesting that an increase in

political contributions leads to a reduced monetary penalty and officer ban, lenient criminal

penalties, and an overall reduction in the likelihood of receiving the most severe civil and criminal

sanctions. The effect is statistically significant except in column 2, when we do not scale monetary

penalty by the compensation of the accused executive.

The *F*-statistic for excluded instruments suggests that the instruments in the first stage of

the IV regressions are highly correlated with the endogenous right-hand-side variable in the second

stage, and that they provide relevant instruments for political contributions. The Anderson-Rubin

Wald *F*-statistic is significant at least at the 10% level except for column 2, which shows that the

instruments in the first-stage regression are strong. None of the Basmann test statistic is statistically

significant at the conventional level. This indicates that our instruments are not over-identified.

The magnitude of the coefficients in these tests is similar to those found in Table 2,

indicating that the effect of political contributions on the severity of government sanctions is

likewise economically meaningful. Table 3 thus confirms the findings in Table 2 that, by limiting

the outcomes of government enforcements, political contributions is beneficial for fraudulent

executives.

4.2.2 Heckman Procedure

Alternatively, we estimate a two-step Heckman procedure taking into account the potential

endogeneity in political contributions.[14] Following Cooper, Gulen and Ovtchinnikov (2010), we

consider in the first step the decision to contribute and obtain the Inverse Mills Ratio (IMR).

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[14] Our findings are also robust to using the Abadie and Imbens (2006) matching framework. The results are available upon request.

"Contributor" takes on a value of one if political contributions occur during the period of the fraud and zero otherwise. We control for firm-specific characteristics at the beginning of the fraud period (i.e., in the first year of the fraud) such as firm size, leverage, cash flows, market share, and market share squared, Herfindahl index, the number of business segments, the number of geographic segments, We also control for industry-specific characteristics that drive a firm's political contributions, such as a dummy variable indicating whether or not the firm's industry is regulated, the percentage of the industry that is unionized, and government purchases. In the second step, we control for self-selection in the decision to contribute by including the IMR, along with control variables on the type, length, and severity of the fraud, as well as other characteristics that may affect the severity of penalty.

Results are displayed in Table 4. After controlling for the decision to make political contributions, contributing executives see significantly lower penalties than non-contributing executives across all specifications.

4.3 Alternative Economic Causes

Both the IV analysis and Heckman procedure help mitigate the concern that the magnitude of penalties may be driven by factors other than political contributions, or that the magnitude of penalties is a consequence of other effects caused by political contributions. To further identify the causal effect of political contributions, we explore alternative hypotheses that might otherwise explain the disparate penalties between fraudulent executives that make generous contributions and those that do not.

4.3.1 Benefit Exceeds Harm to Shareholders

A large literature has documented the impact of political connections on firm value (e.g., Fisman 2001; Jayachandran 2006). Thus, the SEC and/or DOJ may impose a less severe sanction

on an executive from a firm whose net benefit to shareholders is believed to be positive. Put differently, if an executive that has been accused of fraud has otherwise managed the firm well and has, on balance, increased shareholder wealth through his contribution to firm activities, the SEC/DOJ may take the net effect of his work into consideration and propose a less severe penalty since shareholders are better off with the firm in place.

To take into account the potential net benefit to shareholders, we include in our baseline regressions a proxy for the benefit accrued to the shareholders by accused executives: the firm's return on equity (ROE), measured at the beginning of the fraudulent period. If political contributions do not directly affect the severity of government enforcement, but instead, simply proxy for the potential benefit to shareholders, we would expect that adding this control will cause our variable of interest to lose statistical significance.

Table 5 presents the 2SLS estimates in which political contributions are instrumented by "Daughters" and "Prior Contributions". For brevity, only the second-stage results are tabulated. We find that ROE is not significantly related to the severity of penalties imposed upon accused executives, except in column 5. This suggests that the government does not appear to consider the gains accrued to shareholders when assessing penalties. Furthermore, political contributions continue to be significantly negatively related to the severity of penalty across nearly all specifications, after controlling for the potential benefits they may generate.

4.3.2 Earned Leniency

Another possibility is that if a firm (by extension of its top management) has put its best efforts forth to comply with SEC regulations, this compliance may earn that firm, as well as its employees, leniency for any wrongdoing. In fact, Files (2012) finds evidence of earned leniency in the form of reduced monetary penalties.

To take into account the potential leniency that the firm may have earned by being a "good corporate citizen", we re-estimate our baseline models by including a proxy for corporate governance that approximates managerial entrenchment—whether or not the firm has a classified board.[15] Again, if political contributions simply proxy for earned leniency, we would expect that adding this control will cause our variable of interest to lose statistical significance.

The results are displayed in Table 6. While the presence of a classified board mostly does not affect the penalties assessed from government agencies, "Political Contributions" remains negatively and mostly significantly related to the magnitude of civil and criminal penalties after controlling for managerial entrenchment. This suggests that earned leniency does not fully explain the disparate penalties between contributing executives and non-contributing executives.

4.3.3 Alternative Disciplining Mechanisms

It is possible that the disparate penalties between fraudulent executives that make generous contributions and those that do not is not due to political contributions (or lack thereof), but rather a decision on the part of the agency to take into account other forms of discipline imposed on the executive and/or the firm. Along this line of reasoning, it would make sense for an agency to impose less severe penalties where the executive has already been penalized by the firm or market. For example, the SEC may find it unnecessary to impose an officer ban after the board of directors has terminated the executive for his role in the fraud.[16]

We augment our main analysis by including proxies for alternative discipline mechanisms: termination by the board of directors, delisting by the primary exchanges (in many cases the

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[15] A weak board is especially vulnerable in curbing executive greed, which exacerbates fraud incentives (Haynes, Campbell and Hitt 2017). In particular, a classified board hampers shareholders' ability to gain control of a board, and consequently, to affect their ability to dismiss ineffective CEOs (Fisman et al. 2014).

[16] Desai, Hogan and Wilkins (2006) and Karpoff, Lee and Martin (2008) find that executives are at a higher risk for termination following a restatement due to fraud.

delisted firm ceases to exist), and class action litigation.[17] "Termination" is an indicator variable equal to one if the executive was involuntarily dismissed after revelation of the fraud but prior to the imposition of a penalty by the agency, and zero otherwise. "Delisted" is a binary variable equal to one if the firm was no longer publicly traded on a major exchange at the time the penalty was imposed, and zero otherwise. "Class Action" is equal to one is the executive was subject to a class action involving the same matter as the SEC charges, and zero otherwise.

Table 7 shows limited evidence that the government agencies take into account these disciplining mechanisms when imposing to certain types of penalties. Nevertheless, the negative relationship between political contributions and the penalty imposed by the SEC and DOJ remains, even controlling for market disciplinary mechanisms.

4.4 Other Alternative Specifications

As another robustness check (untabulated), we re-estimate our baseline tests using alternative ways to compute political contributions (contributions during the five years leading up to the first year of the fraud instead of during the fraud period, raw contribution dollars instead of log-transformed). The results are robust. Our findings are invariant when we consider additional controls for whether a decision had been made in an alternate case (i.e., criminal for civil and civil for criminal) upon case resolution, and whether there is also individual contributions from a given executive.

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[17] Heese et al (2017) suggest that politically connected firms are more likely to receive a comment letter. For a cooperating firm, the outcome of these letters is typically either no action or an amendment to the firm's filing. These firms do not appear in our sample (because there was no investigation from the SEC's Division of Enforcement). The only firms that would overlap in the two samples are those that chose to ignore the SEC's Division of Corporate Finance comment letter, which would then result in a referral to the Department of Enforcement. Since lack of compliance would not be seen favorably, this arguably works against us finding results consistent with our hypothesis. It is also noteworthy that the Division of Corporate Finance was created in 2002, so comment letters did not exist for a large part of our sample term.

4.5 Mechanisms

We now explore how political contributions may channel personal benefits to fraudulent executives. Such an analysis is empirically challenging because interactions between politicians and executives are nearly unobservable, and could take the form of phone calls, e-mails or even conversations at social/professional events. Indeed, finding a reliable, concrete link between political contributions and favors promised by members of Congress is a difficult, if not impossible, task. In support of this logic, an article in the Wall Street Journal notes that when executives and politicians do not want a record of communication, they often use the code "LDL", which stands for "let's discuss live". Nevertheless, in this subsection, we explore two potential mechanisms through which political contributions may allow fraudulent executives to receive lenient sanctions.

4.5.1 Agency's Discretion in the Outcome

When cases are brought to a federal court, the SEC can propose sanctions but the decision is ultimately left to the court (either the judge or a jury). Often these cases are settled prior to court judgment, in which case the agency has greater control over the penalty(ies). Likewise, cases prosecuted by the DOJ can either result in a court judgment or be settled by the agency through a plea bargain. Penalties determined by courts are usually significantly harsher. In our sample, for instance, fraudulent executives face $8.85 million more in monetary penalty and 3.28 more years in prison if penalties are imposed by the court. *Ceteris paribus*, fraudulent executives would prefer the penalties be imposed by the government agencies rather than by the court.

To consider this distinction, which may affect the severity of government penalty, we hand collect data on the resolution of the case. We construct "Settlement/Plea Bargain", a dummy variable set to one when the penalty results from a settlement with the SEC or a plea bargain with the DOJ, and zero when the penalty is imposed by the court (either the judge or a jury). In instances

where we could not find information as to whether the outcome of the case took the form of a court judgment or a settlement/plea bargain, we assume that a settlement/plea bargain was used. This assumption is based on the fact that the majority of our sample (56% of civil cases and 82% of criminal cases) is resolved through a settlement or plea bargain. This assumption will obviously only bias against us finding the results in cases where a judgment was actually made.[18] We also rank the extent of punishment with "Severity", a categorical variable equal to five if an accused executive receives both officer ban and prison term, four if he receives prison term, three if there is an officer ban, two if there is probation, one if there is monetary penalty, and zero if no penalties are imposed. By construction, this variable captures the severity of the government enforcement.

In column 1 of Table 8, we regress "Severity" on the dummy for settlement with the SEC or plea bargain with the DOJ. Columns 1 and 2 confirm that when courts determine penalties, the penalties are significantly harsher, as the coefficient for the dummy variable "Settlement/Plea Bargain" is negative and is significant at the 1% level. This implies that all else equal, the accused executives would prefer the penalties set by the government agencies (SEC and/or DOJ) rather than by the court.

To provide further evidence that political contributions affect severity of penalties by increasing the propensity to avoid court judgment, we follow Francis et al. (2005) and Yu and Yu (2011) and decompose the dummy for settlement and plea bargain into two components: the predicted and residual values from regressing "Settlement/Plea Bargain" on "Political

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[18] An example of this is Citigroup's proceedings. Citigroup and its executives were accused of deceiving investors by betting against more than $1 billion in mortgage backed securities sold to investors. The SEC offered to settle with Citigroup in exchange for a $285 million penalty, an amount Judge Radkoff referred to as mere "pocket change". ("Appeals court delays SEC Citigroup fraud case", December 27, 2011, Reuters, and "For S.E.C., court ruling on penalties ties a hand", November 30, 2011, The New York Times). Following Judge Radkoff, in a separate matter Judge Rudolph T. Randa requested the SEC explain how the agency's proposed settlement with Koss Corporation was "fair, adequate, and in the public's interest" ("An S.E.C. fraud settlement questioned, gets approved", February 2, 2012, The New York Times).

Contributions". By construction, the predicted component, "Predicted Settlement/Plea Bargain",
captures the extent of the propensity to settle with government agencies that stems from the
executive's political contributions. The residual component captures the variations in
"Settlement/Plea Bargain" unrelated to political contributions.

Columns 3 and 4 of Table 8 reveal that the coefficient for "Predicted Settlement/Plea
Bargain" is negative and is significant at the 1% level. This suggests that political contributions
allow accused executive to receive less harsh, and certainly more desirable sanctions by settling
with the government agencies instead of going to the court.

4.5.2 Duration of Settlement

Katz (2010) points out that enforcement actions inside the SEC that take longer to resolve
are often closed with no resulting penalties, particularly when a new attorney is assigned the case
or a new commissioner is appointed. This implies that if an executive can delay resolution of the
case long enough, he could potentially also reduce the severity of the penalty imposed by the SEC.
We examine this relationship in light of political contributions. Since we do not have any rationale
for the DOJ that is similar to Katz's (2010) argument for the SEC, we focus on the civil penalties
imposed by the SEC in this set of analysis. If political contributions from fraudulent executives
help delay enforcement outcomes by increasing time-to-resolution and the implications of Katz
(2010) hold in our sample, the lengthening of case time-to-resolution may provide a mechanism
through which political contributions affect the severity of penalties imposed by the SEC.

We compute "Case Age" as the number of months (or fraction thereof) from initiation of
the formal charges until the new SEC commissioner assumes power. A higher value of this variable
reflects how "old" the case is when the new commissioner begins his/her assignment. We also
construct "Civil Severity", a categorical variable set to two if a fraudulent executive receives the

most harsh civil penalty—officer ban, one if there is monetary penalty, and zero if no civil penalties are involved. A higher value of this variable suggests a more severe civil penalty.

In light of Katz's assertion that cases taking distinctly longer to resolve receive lenient treatment, we first test for the direct effect of case age on the severity of civil penalty using a piecewise linear specification—a spline. A spline specification allows the slope coefficient to vary with different levels of case age until the arrival of a new SEC commissioner. We choose the spline cutoff points based on the quintiles of the case age variable. The spline regression results in columns 1 and 2 of Table 8 Panel B confirm Katz's assertion. Fraudulent cases that take sufficiently longer time to resolve receive less severity sanctions when a new commissioner is appointed.

Next, in a similar vein as the tests of court avoidance in Table 8 Panel A, we explore whether the delay in the time a case takes to reach a resolution with the SEC is the underlying factor affecting the difference in severity of civil penalties between fraudulent executives that make generous contributions and those that do not. We decompose "Case Age" into the predicted and residual components by regressing "Case Age" on "Political Contributions". By construction, the predicted component, "Predicted Case Age", captures the extent of the delay in case resolution until the arrival of a new SEC commissioner driven by political contributions from accused executives. Since the case age is highly skewed, we also take the log transformation of the predicted value of case age at new SEC commissioner.

Columns 3-4 of Panel B reveal that the predicted case age is negatively and significantly related to the severity of civil penalty. We interpret this as evidence consistent with the argument that lengthening the time to resolution due to the political contributions allows for less severe civil penalties.

5. The Effect of Political Contributions on Loss Accrued to Shareholders

So far, we have shown that political contributions limit the adverse effect of government penalties imposed upon fraudulent executives. In light of Correia (2014), who shows that political spending reduces the monetary penalties that a fraudulent firm received from the SEC, our findings suggest that the SEC capture through political connections is prevalent not only at firm level, but also occurs at individual level. More importantly, the SEC may substitute a large penalty on the firm for a smaller penalty on the manager because it believes the firm-level penalties encourage optimal internal monitoring and enforcement.[19] As a result, political contributions may lead to a distortion in the enforcement process that benefits managers, even if that means shifting the consequences to the shareholders.

In this section, we examine how the amount of fines that the SEC imposes on firms varies with the severity of sanctions it applies to individual executives, and to what extent political contributions affect this process. Similar to our mechanisms analyses, we first regress "Severity" on "Political Contributions" to generate the predicted component and multiple it by 100. "Predicted Severity" thus captures the extent that political contributions reduce the severity of government penalty imposed upon an accused executive. Table 9 Panel A shows that "Predicted Severity" is negatively and significantly associated with "Firm Fine". As the severity of penalty imposed upon the fraudulent executives goes down due to their larger political contributions, the amount of fine imposed on firm goes up. These results suggest that political contributions facilitate the "transfer" of penalty between fraudulent managers and shareholders.

In a similar vein, we further explore whether CEOs are able to avoid termination following the shift of penalties from fraudulent executives to the shareholders in Panel B of Table 9. To

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[19] For a discussion on whether it is optimal to have firm-level or manager-level penalties, see, e.g., Arlen (1998).

capture the extent that political contributions influence the amount of government punishment a firm receives, we use the predicted component from regressing "Firm Fine" on "Political Contributions". In light of the findings in Panel A, when political contributions allow for a stronger substitution between penalties imposed on fraudulent executives and on their firm, a larger fitted value suggests a greater degree of penalty transfer.

We then regress "Predicted Firm Fine" on the likelihood of CEO termination and report the marginal effects from the probit regressions in columns 1 and 2. In column 3, we control for, additionally, executive age and corporate governance such as classified board, which are highlighted in extant literature as important in CEO turnover. We also include alternative market-based disciplining mechanisms such as class action lawsuit and delisting, which may contribute to an executive turnover. Panel B shows that when the firm receives larger fines, its CEO is less likely to face job termination. Put differently, as the fraudulent executive shifts the penalty from himself on to the firm's shareholders, he decreases the likelihood of his own termination.

Overall, Table 9 provides evidence that less severe penalties at executive level are associated with larger fines from the SEC that cost shareholders, and political contributions exacerbate such a relationship. This findings implies that political contributions allow fraudulent executives to circumvent the traditional mechanisms for discipline that are implemented by society for fraud, and may even allow for them to entrench themselves further.

6. Conclusions

In this paper, we manually assemble a set of data on penalties from government sanctions and examine the effect of political contributions on the severity of government enforcement imposed on fraudulent executives. We show that an increase in political contributions is associated

with a significant reduction in monetary penalties, the number of years an executive is banned as an officer, sentenced to probation or prison, as well as a reduction in the probability that he will receive both an officer ban and prison time. These results are consistent with contributing executives facing less severe penalties from the SEC (in the case of civil penalties) or the DOJ (in the case of criminal penalties).

Further analyses suggest that the net benefit accrued to shareholders, earned leniency, as well as alternative market disciplines do not fully explain our findings. When exploring potential mechanisms, political contributions allow fraudulent executives to receive less harsh penalties by reducing the likelihood of having the court assessing the penalty. They also help lengthening the case time-to-settle with the SEC, resulting less severe civil penalty. Our findings provide the first evidence on how individual executives may use political connections for personal benefit. In particular, there is evidence that political connections help facilitate the shift of fraud consequences from managers to shareholders.

These findings shed light on the factors determining the effectiveness of disciplinary mechanisms to discourage fraud. In particular, prior literature indicates that managers responsible for corporate financial fraud suffer negative career and monetary consequences. By documenting that political contributions lead to less severe sanctions, we highlight a mechanism that can undermine the disciplining effect for fraudulent managers and potentially exacerbate an executive's ex-ante incentive to commit fraud.

Appendix: Variable Definitions

Variable	Definition
# of Accused Executives	The natural logarithm of the number of accused executives at a given firm. Source: AAERs.
Civil Severity	A categorical variable equal to zero if the accused executive receives no civil penalties from the SEC, one if monetary penalty is imposed, and two if an officer ban is imposed. Source: Manual Collection.
Class Action	A dummy variable equal to one if a firm was subject to a shareholder class action litigation regarding the same matter as the SEC/DOJ investigation and zero otherwise. Source: Stanford Securities Class Action Clearinghouse.
Classified Board	A dummy variable equal to one if the firm has a classified board in the year penalties are imposed, and zero otherwise. Source: SEC EDGAR Proxy Statements.
Damages	The natural logarithm of the average size of the fraud (measured in dollars), as calculated by the SEC. Source: AAERs.
Daughters	The average annual number of Congressional members that have any daughters in the state where the firm whose executive is accused for fraud is headquartered scaled by the average number of Congressional seats, both of these averages calculated over the fraudulent period. Sources: Congressional Directories and Manual Collection.
Delisted	A dummy variable equal to one if the firm is no longer publicly listed when penalties are imposed or went bankrupt prior to the time the penalty was imposed, and zero otherwise. Source: Lexis-Nexis.
Duration of Fraud	The natural logarithm of the number of years (or portion thereof) from the beginning of the fraud until the conclusion of the fraud. Source: AAERs.
Firm Fine	The natural logarithm of one plus the dollar amount of fine imposed on the firm by the SEC. Source: AAERs and Compustat.
Lobbying	A dummy variable equal to one if a firm has lobbying activities. Source: Center for Responsive Politics.
Monetary Penalty	The natural logarithm of one plus the amount of monetary penalties (in $MM) imposed on the executive by the SEC. Source: AAERs.
Monetary Penalty/ Compensation	The natural logarithm of one plus the amount of monetary penalty imposed on the accused executive by the SEC, scaled by the compensation of the accused executive. Source: AAERs, Execucomp and SEC EDGAR.
Officer Ban	The natural logarithm of one plus the number of years the accused executive is banned as an officer. Source: AAERs.
Political Contributions	The natural logarithm of one plus the average annual amount (in $10,000s) of political contributions that an accused executive made during the period of fraud. We include both contribution from the firm via PAC and contributions made directly by the accused executive. Sources: Federal Election Commission and Center for Responsive Politics.

Prior Contributions	A dummy variable equal to one if the firm has PAC contributions 15 years ago and zero otherwise. Source: Federal Election Commission.
Prison	The natural logarithm of one plus the number of years of prison that the accused executive received. Sources: AAERs, Corporate Counsel Fraud Database, Offices of the US Attorneys, and Lexis-Nexis.
Prison & Ban	An indicator variable equal to one if the accused executive receives both prison time and an officer ban, and zero otherwise. Sources: AAERs, Corporate Counsel Fraud Database, Offices of the US Attorneys, and Lexis-Nexis.
Probation	The natural logarithm of one plus the number of years of probation the accused executive received. Sources: AAERs, Corporate Counsel Fraud Database, Offices of the US Attorneys, and Lexis-Nexis.
Republican-appointed Chief	A dummy variable equal to one if the head of the respective agency (Commissioner for the SEC or Attorney General for the DOJ) was appointed by a republican president and zero if the head of the agency was appointed by a democratic president. Party affiliation is measured at the time penalties are imposed. Source: SEC and DOJ websites.
ROE	Return on equity defined as income before extraordinary items scaled by shareholder's equity. ROE is measured in the first year of the fraud. Source: CRSP and Compustat.
Settlement/Plea Bargain	A dummy variable equal to one if the case ended in a settlement (civil case) or plea bargain (criminal case), and equal to zero otherwise. Sources: AAERs, Corporate Counsel Fraud Database, Offices of the US Attorneys, and Lexis-Nexis.
Severity	A categorical variable equal to 5 if both prison and officer ban are imposed, 4 for prison term, 3 for an officer ban, 2 for probation, 1 if there is monetary penalty, and zero if no penalty is imposed. Source: Manual Collection.
Size	The natural logarithm of the firm's average market cap during the fraudulent period. Source: Compustat.
Small Firm	A dummy variable equal to one if the firm's total assets are less than $200 million.
SOX	A dummy variable that equals one if the resolution date occurs after the enactment of Sarbanes-Oxley (July 30, 2002) and zero otherwise.
Termination	A dummy variable equal to one if the executive was involuntarily dismissed after revelation of the fraud but prior to the imposition of a penalty by the agency and zero otherwise. Termination is calculated using the methodology of Parrino (1997). Sources: Execucomp, SEC EDGAR, and Lexis-Nexis.
Time to Settle	The natural logarithm of the number of years (or fraction thereof) from the formal charges by the SEC until the resolution (settlement or court judgment). Source: AAERs.

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Figure 1: Timeline of SEC Enforcement Action

The figure below, adapted from Karpoff et al. (2008), illustrates the timeline of the SEC enforcement actions for our sample. "Beginning Fraud" is the fiscal year in which the executive first became engaged in the fraudulent behavior. "End Fraud" is the last fiscal year of the alleged fraud. "Time to Enforcement" is the difference between the last fiscal year of the fraud and the formal filing of the SEC complaint (for civil actions). "Regulatory Period" represents the time from the formal filing of the action by the SEC until the final resolution by the SEC. The resolution date typically refers to the resolution of the civil action; criminal actions may not be resolved until a later point in time.
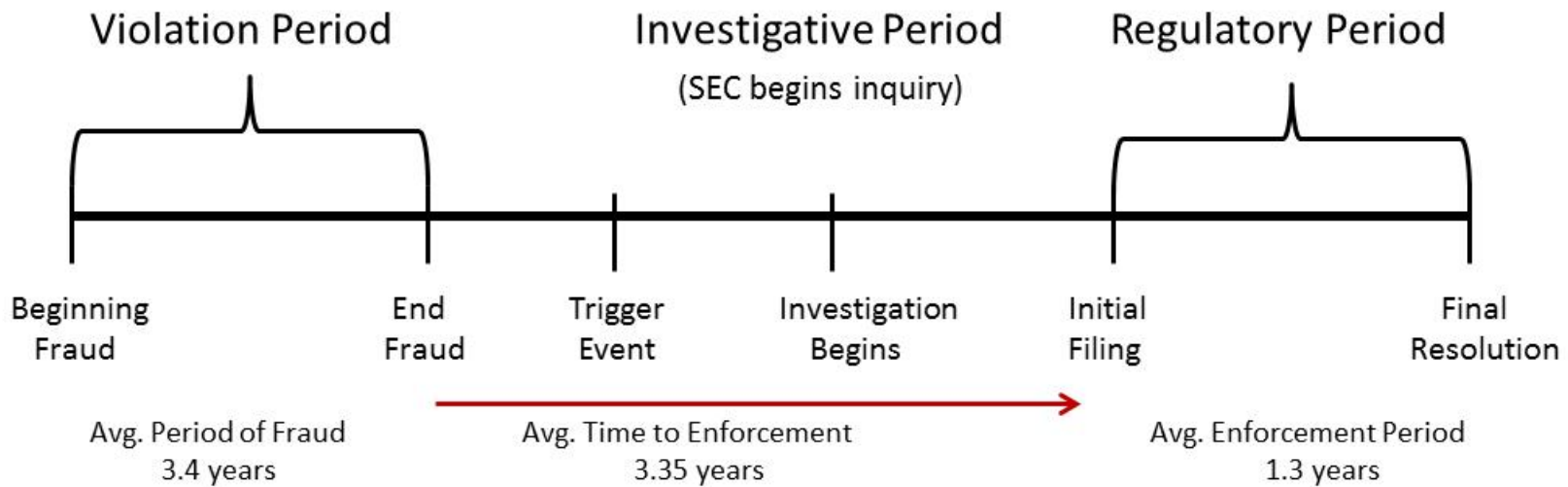
Table 1: Descriptive Statistics

The sample period is 1999-2010. In Panel A, "Contributor" is a dummy variable equal to one if an accused executive and his firm made political contributions during the sample period and zero otherwise. Panel B reports the distribution of the roles of the accused executives and the types of fraud they are accused of. CEO is the Chief Executive Officer. CFO is the Chief Financial Officer. COO is the Chief Operating Officer. CIO is the Chief Information Officer. CAO is the Chief Accounting Officer. Panel C reports the descriptive statistics of enforcement types. The last column reports the Wilcoxon rank-sum test statistics comparing the contributing and the non-contributing subsamples. ***, **, and * indicate significance at the 1%, 5%, and 10% level, respectively.

Panel A: Political Contributions and Fraud Characteristics

	# of obs.	Mean	Std. Dev.	Min	Max
Contributor	452	0.35	0.48	0	1
Political Contribution ($10,000)	452	1.54	4.52	0	33.24
Total Assets ($ millions)	452	9,273.97	40,301.21	2.50	492,982
Firm Fine ($ millions)	452	40.55	245.47	0.00	2,250
Damages ($ millions)	452	498.81	1,536.21	0.09	11,000
# of Accused Executives	452	3.68	2.15	1	9
Duration of Fraud (years)	452	3.30	2.29	1	16

Panel B: Executives and Fraud Type

	# of obs.	Earnings Fraud	Securities Fraud	Options Backdating	Bribery	Insider Trading	Embezzlement
CAO	18	17	5	2	0	1	0
CEO	79	71	17	11	0	6	0
CFO	144	132	23	14	0	10	2
Chairman	5	4	0	1	0	0	0
CIO	1	1	0	0	0	0	0
Controller	67	63	8	4	0	3	1
COO	15	15	1	1	0	2	0
Director	13	9	3	2	1	0	0
General Counsel	10	10	1	3	0	0	1
President	13	12	1	0	1	0	0
Treasurer	2	2	1	0	0	0	0
Vice President	85	75	14	5	1	4	0
Total	452	411	74	43	3	26	4

Table 2: Political Contributions and Government Penalties

This table relates political contributions to the severity of government penalties. The dependent variables are indicated on top of each column. Columns 1-5 report marginal effects from the tobit regressions and column 6 reports the marginal effects from the probit regression. All models include both a constant and fixed effects as describe in the table, but coefficients are not tabulated. Industry classifications are based on 1-digit SIC code. Variable definitions are in the Appendix. Robust standard errors clustered at the role of the accused executive are in brackets. ***, **, and * indicate significance at the 1%, 5%, and 10% level, respectively.

Dependent Variable	Monetary Penalty	Monetary Penalty/ Compensation	Officer Ban	Probation	Prison	Prison & Ban
	(1)	(2)	(3)	(4)	(5)	(6)
Political Contributions	-0.10**	-0.20***	-0.49***	-1.14***	-0.72***	-0.52***
	[0.040]	[0.062]	[0.018]	[0.017]	[0.017]	[0.168]
Lobbying	-0.11	-0.77***	0.67***	2.31***	1.88***	0.76***
	[0.128]	[0.198]	[0.033]	[0.039]	[0.070]	[0.111]
Size	0.11***	0.07*	-0.07***	-0.04***	-0.14***	-0.07
	[0.028]	[0.038]	[0.000]	[0.001]	[0.001]	[0.062]
Small Firm	0.16*	0.62***	0.01	0.91***	0.15***	0.04
	[0.085]	[0.139]	[0.018]	[0.023]	[0.022]	[0.152]
Damages	0.10**	0.11**	0.04***	-0.06***	-0.05***	-0.05**
	[0.052]	[0.051]	[0.000]	[0.000]	[0.001]	[0.023]
# of Accused Executives	-0.09	-0.07	0.31***	0.75***	0.34***	0.25
	[0.119]	[0.051]	[0.005]	[0.017]	[0.011]	[0.211]
Duration of Fraud	0.17*	0.32***	0.35***	-0.04***	-0.48***	-0.27*
	[0.098]	[0.107]	[0.011]	[0.010]	[0.006]	[0.141]
Republican Appointed Chief	-0.18	-0.47***	0.07***	6.45***	-0.32***	-0.2
	[0.220]	[0.163]	[0.019]	[0.021]	[0.020]	[0.179]
SOX	0.56**	-0.54***	-10.46***	1.85***	-5.02***	-0.92***
	[0.277]	[0.177]	[0.020]	[0.023]	[0.010]	[0.062]
Fraud Type FE	Yes	Yes	Yes	Yes	Yes	Yes
Executive Role FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Settlement Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	452	192	452	138	138	132
Pseudo R-squared	0.18	0.24	0.08	0.38	0.28	0.49

Table 3: Instrumental Variable Analysis

We instrument "Political Contributions" with "Daughters" and "Prior Contributions". Column 1 reports the first stage of the IV regression for the endogenous variable "Political Contributions". Columns 2-7 report the second stage estimates for the dependent variables indicated on top of each column. All models include a constant, a set of control variables as in Table 2, and fixed effects as describe in the table, but coefficients are not tabulated. Industry classifications are based on 1-digit SIC code. Variable definitions are in the Appendix. Robust standard errors clustered at the role of the accused executive are in brackets. ***, **, and * indicate significance at the 1%, 5%, and 10% level, respectively.

| Dependent Variable | First Stage | Second Stage | | | | | |
	Political Contributions	Monetary Penalty	Monetary Penalty/ Compensation	Officer Ban	Probation	Prison	Prison & Ban
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Daughters	-1.12***						
	[0.270]						
Prior Contributions	0.74***						
	[0.098]						
Political Contributions		-0.03	-0.35***	-0.65**	-0.66***	-0.90***	-0.29***
		[0.085]	[0.101]	[0.299]	[0.184]	[0.114]	[0.079]
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Executive Role FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Settlement Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
F-Statistic		28.44***	12.51***	28.44***	63.36***	63.36***	63.36***
Anderson-Rubin Wald F-Statistic		0.44	30.68***	5.87*	25.91***	34.84***	19.32***
Basmann χ^2		0.14	0.12	0.39	0.00	0.03	0.04
Observations	452	452	192	452	138	138	138
R-squared	0.60	0.38	0.48	0.21	0.47	0.35	0.48

Table 4: Heckman Procedure

This table reports the second stage estimates of the Heckman procedure to control for self-selection bias in the decision to contribute. The dependent variables are indicated on top of each column. All models include a constant, a set of control variables as in Table 2, and fixed effects as describe in the table, but coefficients are not tabulated. Variable definitions are in the Appendix. Robust standard errors clustered around the role of the accused executive are reported in brackets. *, **, and *** indicate significance levels of 10%, 5%, and 1% respectively.

Dependent Variable	Monetary Penalty	Monetary Penalty/ Compensation	Officer Ban	Probation	Prison	Prison & Ban
	(1)	(2)	(3)	(4)	(5)	(6)
Political Contributions	-0.09**	-0.23***	-0.38***	-1.73***	-0.90***	-0.68**
	[0.039]	[0.059]	[0.021]	[0.023]	[0.037]	[0.300]
Inverse Mills Ratio	-0.14	-0.10*	0.02***	-0.21***	-0.33***	-0.21
	[0.081]	[0.054]	[0.007]	[0.014]	[0.012]	[0.286]
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes	Yes	Yes	Yes
Executive Role FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Settlement Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	418	179	418	126	126	114
R-squared	0.37	0.47	0.09	0.35	0.25	0.44

Table 5: Benefit to Shareholders Exceeds Harm

This table presents the second stage estimates of the IV regressions examining the benefit to the firm's shareholders in comparison to the damage caused by the fraud. We instrument "Political Contributions" with "Daughters" and "Prior Contributions". The dependent variables are indicated on top of each column. All models include a constant, a set of control variables as in Table 2, and fixed effects as describe in the table, but coefficients are not tabulated. Industry classifications are based on 1-digit SIC code. Variable definitions are in the Appendix. Robust standard errors clustered at the role of the accused executive are in brackets. ***, **, and * indicate significance at the 1%, 5%, and 10% level, respectively.

Dependent Variable	Monetary Penalty	Monetary Penalty/ Compensation	Officer Ban	Probation	Prison	Prison & Ban
	(1)	(2)	(3)	(4)	(5)	(6)
Political Contributions	-0.02	-0.37***	-0.62**	-0.72***	-0.89***	-0.29***
	[0.090]	[0.092]	[0.292]	[0.185]	[0.126]	[0.085]
ROE	-0.01	-0.01	-0.01	0.00	0.02*	0.00
	[0.009]	[0.007]	[0.009]	[0.010]	[0.010]	[0.006]
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes	Yes	Yes	Yes
Executive Role FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Settlement Year FE	Yes	Yes	Yes	Yes	Yes	Yes
F-Statistic	26.99***	12.12***	26.99***	40.05***	40.05***	40.05***
Anderson-Rubin Wald F-Statistic	0.34	28.35***	5.07*	23.45***	34.94***	24.50***
Basmann χ^2	0.023	0.068	0.023	0.401	0.186	0.00
Observations	445	191	445	135	135	135
R-squared	0.39	0.47	0.22	0.51	0.38	0.50

Table 6: Earned Leniency

This table presents the second stage estimates of the IV regressions examining the management entrenchment in comparison to the damage caused by the fraud. We instrument "Political Contributions" with "Daughters" and "Prior Contributions". The dependent variables are indicated on top of each column. All models include a constant, a set of control variables as in Table 2, and fixed effects as describe in the table, but coefficients are not tabulated. Industry classifications are based on 1-digit SIC code. Variable definitions are in the Appendix. Robust standard errors clustered at the role of the accused executive are in brackets. ***, **, and * indicate significance at the 1%, 5%, and 10% level, respectively.

Dependent Variable	Monetary Penalty	Monetary Penalty/ Compensation	Officer Ban	Probation	Prison	Prison & Ban
	(1)	(2)	(3)	(4)	(5)	(6)
Political Contributions	-0.14	-0.38***	-0.83**	-0.46**	-0.73***	-0.25***
	[0.139]	[0.144]	[0.341]	[0.223]	[0.057]	[0.066]
Classified Board	-0.05	-0.18	0.02	0.06	0.20**	0.08
	[0.094]	[0.138]	[0.185]	[0.195]	[0.099]	[0.085]
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes	Yes	Yes	Yes
Executive Role FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Settlement Year FE	Yes	Yes	Yes	Yes	Yes	Yes
F-Statistic	24.33***	14.67***	24.33***	22.06***	22.06***	22.06***
Anderson-Rubin Wald F-Statistic	1.33	10.63***	5.64*	8.35**	33.05***	11.32***
Basmann χ^2	0.02	0.029	0.134	0.12	0.365	0.315
Observations	364	168	364	114	114	114
R-squared	0.40	0.46	0.24	0.63	0.59	0.55

Table 7: Alternative Disciplining Mechanisms

This table presents the second stage estimates of IV regressions examining market-based disciplining mechanisms. We instrument "Political Contributions" with "Daughters" and "Prior Contributions". The dependent variables are indicated on top of each column. All models include a constant, a set of control variables as in Table 2, and fixed effects as describe in the table, but coefficients are not tabulated. Industry classifications are based on 1-digit SIC code. Variable definitions are in the Appendix. Robust standard errors clustered at the role of the accused executive are in brackets. ***, **, and * indicate significance at the 1%, 5%, and 10% level, respectively.

Dependent Variable	Monetary Penalty	Monetary Penalty/ Compensation	Officer Ban	Probation	Prison	Prison & Ban
	(1)	(2)	(3)	(4)	(5)	(6)
Political Contributions	0.04	-0.38***	-0.63**	-0.68***	-0.85***	-0.28**
	[0.104]	[0.104]	[0.282]	[0.190]	[0.137]	[0.114]
Class Action	0.00	-0.01***	0.01***	-0.01	0.01	0.00
	[0.004]	[0.002]	[0.004]	[0.009]	[0.011]	[0.005]
Termination	0.34***	0.20***	0.39***	-0.08	0.13	0.11
	[0.078]	[0.066]	[0.048]	[0.113]	[0.228]	[0.097]
Delisted	0.04	0.20***	0.17*	0.03	0.14	-0.06
	[0.086]	[0.024]	[0.096]	[0.114]	[0.155]	[0.070]
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes	Yes	Yes	Yes
Executive Role FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Settlement Year FE	Yes	Yes	Yes	Yes	Yes	Yes
F-Statistic	27.90***	32.51***	27.90***	131.82***	131.82***	131.82***
Anderson-Rubin Wald F-Statistic	2.85	28.19***	6.63**	15.18***	43.24***	8.81**
Basmann Chi-squared	0.191	0.388	1.049	0.015	0.022	0.022
Observations	420	183	420	135	135	135
R-squared	0.40	0.50	0.25	0.46	0.38	0.49

Table 8: Mechanisms

Panel A: Agency Discretion in the Outcome

This table presents the ordered probit regression results examining how the effect of political contributions on the severity of government enforcement varies with a government agency's discretion. The dependent variable is "Severity", a variable equal to 5 if both prison and officer ban are imposed, 4 for prison term, 3 for an officer ban, 2 for probation, 1 if there is monetary penalty, and zero if no penalty is imposed. "Settlement/Plea Bargain" is a dummy variable equal to one if the penalty results from a settlement with the SEC and/or plea bargain with the DOJ, and zero if the penalty is imposed by the court (either the judge or a jury). "Predicted Settlement/Plea Bargain" is the predicted value from regressing "Settlement/Plea Bargain" on "Political Contributions", multiplied by 100. All models include a constant, a set of control variables as in Table 2, and fixed effects as describe in the table, but coefficients are not tabulated. Industry classifications are based on 1-digit SIC code. Variable definitions are in the Appendix. Robust standard errors clustered around the role of the accused executive are in brackets. ***, **, and * indicate significance at the 1%, 5%, and 10% level, respectively.

Dependent Variable	Severity			
	(1)	(2)	(3)	(4)
Settlement/Plea Bargain	-1.67***	-2.03***		
	[0.195]	[0.178]		
Predicted Settlement/Plea Bargain			-0.58***	-0.74***
			[0.153]	[0.131]
Control Variables	Yes	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes	Yes
Executive Role FE	No	Yes	No	Yes
Industry FE	No	Yes	No	Yes
Settlement Year FE	No	Yes	No	Yes
Observations	452	452	452	452
Pseudo R-squared	0.06	0.11	0.03	0.08

Table 8 continued.

Panel B: Case Age at New Commissioner

This table presents the ordered probit regression results examining how political contributions affect civil penalty imposed upon fraudulent executives via increasing time-to-resolution with the SEC. The dependent variable is "Civil Severity", set to two for officer ban, one for monetary penalty, and zero for no civil penalty. Columns 1-2 report the spline regression results. "Case Age" is the number of months between the date of the case filed and the time when a new SEC commissioner assumes power. If the case is resolved prior to the appointment of a new commissioner, this variable is the difference between the date of resolution and the time when the case is filed. "Predicted Case Age" is the predicted value from regressing "Case Age" on "Political Contributions". All models include a constant, a set of control variables as in Table 2, and fixed effects as describe in the table, but coefficients are not tabulated. Industry classifications are based on 1-digit SIC code. Variable definitions are in the Appendix. Robust standard errors clustered around the role of the accused executive are in brackets. ***, **, and * indicate significance at the 1%, 5%, and 10% level, respectively.

Dependent Variable	Civil Severity			
	(1)	(2)	(3)	(4)
Spline 1 (Shortest Case Age)	0.01	0.01		
	[0.008]	[0.008]		
Spline 2	0.00	0.00		
	[0.013]	[0.014]		
Spline 3	-0.03	-0.04		
	[0.028]	[0.029]		
Spline 4	0.02	0.03		
	[0.038]	[0.036]		
Spline 5 (Longest Case Age)	-0.04*	-0.08***		
	[0.019]	[0.029]		
Predicted Case Age			-0.06**	-0.08**
			[0.028]	[0.035]
Control Variables	Yes	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes	Yes
Executive Role FE	No	Yes	No	Yes
Industry FE	No	Yes	No	Yes
Settlement Year FE	No	Yes	No	Yes
Observations	452	452	452	452
Pseudo R-squared	0.05	0.14	0.05	0.14

Table 9: Political Contributions and Penalty Shift to Shareholders

Panel A reports the marginal effects from a tobit regression relating the severity of penalty imposed on accused executives on the fine their firm receives from the SEC. The dependent variable is "Firm Fine", calculated as the natural logarithm of one plus the amount of fines the SEC imposes on the firm for the fraudulent activities conducted by its executive. This variable is set to zero if the firm is not fined. "Severity" is a categorical variable equal to five if an executive receives both prison term and officer ban, four for prison term, three for an officer ban, two for probation, one if there is monetary penalty, and zero if no penalty is imposed. We generate "Predicted Severity" by regressing "Severity" on "Political Contributions". Panel B reports the marginal effects from a probit regression relating predicted firm fine to the likelihood of CEO termination. The dependent variable is a dummy set to one for CEO termination. We generate "Predicted Firm Fine" by regressing "Firm Fine" on "Political Contributions" on. All models include a constant, a set of control variables, and fixed effects as describe in the table, but coefficients are not tabulated. Control variables include "Damages", "Size", "Small Firm", "# of Accused Executives", "Duration of Fraud", "SOX", "Republican Appointed Chief", and "Lobbying". Industry classifications are based on 1-digit SIC code. Variable definitions are in the Appendix. Robust standard errors clustered around the role of the accused executive are in brackets. *, **, and *** indicate significance levels of 10%, 5%, and 1% respectively.

Panel A: Damage Shift

Dependent Variable	Firm Fine		
	(1)	(2)	(3)
Predicted Severity	-5.76***	-7.84***	-7.67***
	[0.890]	[0.037]	[0.033]
ROE			1.89***
			[0.037]
Class Action			0.83***
			[0.243]
Delisted			-27.37***
			[0.678]
Control Variables	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes
Executive Role FE	No	Yes	Yes
Industry FE	No	Yes	Yes
Settlement Year FE	No	Yes	Yes
Observations	452	452	445
Pseudo R-squared	0.22	0.26	0.31

Table 9 continued.

Panel B: CEO Termination

Dependent Variable	CEO Termination		
	(1)	(2)	(3)
Predicted Firm Fine	-0.03**	-0.04***	-0.04**
	[0.013]	[0.016]	[0.019]
ROE			0.00
			[0.004]
Class Action			0.27***
			[0.051]
Delisted			-0.03
			[0.083]
Classified Board	0.01	-0.05	-0.05
	[0.043]	[0.056]	[0.067]
CEO Age	0.13	0.19*	0.27**
	[0.106]	[0.108]	[0.117]
Control Variables	Yes	Yes	Yes
Fraud Type FE	Yes	Yes	Yes
Executive Role FE	No	Yes	Yes
Industry FE	No	Yes	Yes
Settlement Year FE	No	Yes	Yes
Observations	357	357	353
Pseudo R-squared	0.05	0.14	0.16