

SEC Regulation Fair Disclosure, Information, and the Cost of Capital*

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Abstract

We empirically investigate the effects of the adoption of Regulation Fair Disclosure (“Reg FD”) by the U.S. Securities and Exchange Commission in October 2000. This rule was intended to stop the practice of “selective disclosure,” in which companies give material information only to a few analysts and institutional investors prior to disclosing it publicly. We find that the adoption of Reg FD caused a significant reallocation of information-producing resources, resulting in a welfare loss for small firms, which now face a higher cost of capital. The loss of the “selective disclosure” channel for information flows could not be compensated for via other information transmission channels. This effect was more pronounced for firms communicating complex information and, consistent with the investor recognition hypothesis, for those losing analyst coverage. Moreover, we find no significant relationship of the different responses with litigation risks and agency costs. Our results suggest that Reg FD had unintended consequences and that “information” in financial markets may be more complicated than current finance theory admits.

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