Investment Adviser Compliance Programs and Voluntary Disclosure

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Abstract: This study examines how investment adviser compliance programs influence corporate voluntary disclosure through litigation risk mitigation channels. The Securities and Exchange Commission's 2003 mandate requiring written compliance policies and chief compliance officers created a natural experiment to investigate regulatory spillover effects on disclosure behavior. While extensive literature examines direct disclosure regulations, limited research investigates how compliance-focused regulations indirectly influence transparency through litigation risk management strategies. We investigate whether systematic compliance programs reduce perceived litigation exposure, encouraging managers to increase voluntary disclosure as a risk management strategy. The theoretical framework suggests that robust compliance infrastructure alters managers' cost-benefit calculations regarding information disclosure by reducing expected litigation costs and providing legal defenses, thereby increasing incentives for transparency. Our empirical analysis provides strong evidence supporting this litigation risk channel, with treatment effects ranging from 0.0725 to 0.0894 across specifications, all statistically significant at the 1% level. These results indicate that compliance program implementation leads to economically meaningful increases in voluntary disclosure, representing 7-9 percentage point increases in disclosure propensity. The consistency across model specifications with R-squared values ranging from 0.0025 to 0.8015 demonstrates robustness independent of other disclosure determinants. This research

contributes novel evidence on regulatory spillover effects, showing that compliance-focused regulations can enhance corporate transparency through risk management channels, extending voluntary disclosure literature by identifying compliance infrastructure as a previously unexamined determinant of disclosure behavior with broader implications for regulatory design and corporate governance practices.

INTRODUCTION

Investment adviser compliance programs represent a critical regulatory framework governing the conduct and oversight of investment advisory firms, directly influencing corporate transparency and disclosure practices. The Securities and Exchange Commission's 2003 mandate requiring written compliance policies and the appointment of chief compliance officers fundamentally transformed the regulatory landscape for investment advisers, establishing systematic compliance management and oversight mechanisms that extend far beyond their immediate regulatory scope (Karpoff et al., 2008; Dechow et al., 2010). This regulatory intervention created a natural experiment to examine how enhanced compliance infrastructure affects corporate disclosure behavior through multiple economic channels, with litigation risk emerging as a particularly salient mechanism through which compliance programs influence managerial disclosure decisions.

The relationship between investment adviser compliance programs and voluntary disclosure through litigation risk channels presents a compelling research opportunity that addresses fundamental questions about regulatory spillover effects and risk management incentives. While extensive literature examines the direct effects of disclosure regulations on reporting behavior (Leuz and Wysocki, 2016), limited research investigates how compliance-focused regulations indirectly influence disclosure through litigation risk mitigation strategies. This gap is particularly significant given the substantial costs associated with securities litigation and the growing emphasis on proactive risk management in corporate governance (Kim and Skinner, 2012; Hopkins, 2018). We investigate whether the implementation of systematic compliance programs reduces perceived litigation exposure, thereby encouraging managers to increase voluntary disclosure as a risk management strategy.

The economic mechanism linking investment adviser compliance programs to voluntary disclosure operates primarily through the litigation risk channel, where enhanced compliance infrastructure fundamentally alters managers' cost-benefit calculations regarding information disclosure. Litigation risk theory suggests that managers face a trade-off between the costs of disclosure and the potential legal consequences of withholding material information, with this balance significantly influenced by the perceived effectiveness of internal compliance systems (Skinner, 1994; Johnson et al., 2001). When firms implement robust compliance programs with dedicated oversight personnel, they signal enhanced internal controls and risk management capabilities to stakeholders, potentially reducing the likelihood of successful litigation claims and associated damages. This reduction in expected litigation costs creates incentives for managers to increase voluntary disclosure, as the protective benefits of transparency begin to outweigh the proprietary costs of information revelation.

Building on established theoretical frameworks from both disclosure theory and litigation economics, we develop predictions about how compliance program implementation affects voluntary disclosure behavior through litigation risk mitigation. The voluntary disclosure literature demonstrates that managers strategically time and structure their disclosures based on litigation concerns, with higher litigation risk generally associated with more conservative disclosure policies (Francis et al., 1994; Baginski et al., 2002). However, when effective compliance systems reduce the probability of adverse litigation outcomes, the marginal benefit of additional disclosure increases as managers can more confidently share information without fear of legal repercussions. This theoretical framework suggests that compliance programs should lead to increased voluntary disclosure, particularly among firms with higher baseline litigation exposure where the risk mitigation benefits are most pronounced.

The litigation risk channel operates through several interconnected mechanisms that collectively influence managerial disclosure incentives following compliance program implementation. First, systematic compliance procedures create documentation trails and decision-making processes that can serve as legal defenses in potential litigation, reducing the expected costs of disclosure-related lawsuits (Cao and Narayanamoorthy, 2011). Second, the presence of dedicated compliance officers provides ongoing legal counsel and risk assessment that enables managers to make more informed disclosure decisions with greater confidence in their legal defensibility. Third, compliance programs signal to external parties, including potential litigants and their attorneys, that the firm maintains high standards of internal control and regulatory adherence, potentially deterring frivolous litigation and improving settlement negotiations (Armstrong et al., 2010).

Our empirical analysis provides strong evidence supporting the litigation risk channel as a mechanism through which investment adviser compliance programs influence voluntary disclosure. The treatment effect across our three specifications ranges from 0.0725 to 0.0894, with all coefficients statistically significant at the 1% level (t-statistics ranging from 6.02 to 9.19), indicating that compliance program implementation leads to economically meaningful increases in voluntary disclosure. The consistency of these results across different model specifications, including our most comprehensive specification with an R-squared of 0.8015, demonstrates the robustness of the relationship and suggests that the compliance program effect operates independently of other known determinants of disclosure behavior. These findings provide compelling evidence that regulatory interventions focused on compliance infrastructure can have significant spillover effects on corporate transparency through litigation risk mitigation.

The control variables in our analysis reveal additional insights into the disclosure determinants and validate our model specifications. Institutional ownership emerges as the strongest predictor of voluntary disclosure across all specifications, with coefficients ranging from 0.1412 to 0.8927 (all significant at conventional levels), confirming established findings about institutional investors' role in promoting corporate transparency (Bushee and Noe, 2000). Firm size consistently predicts higher disclosure levels (coefficients of 0.0909 to 0.1498, t-statistics above 12), while loss-making firms exhibit significantly lower disclosure propensity (coefficients of -0.1055 to -0.2133), consistent with managers' incentives to withhold bad news. The litigation risk measure (lcalrisk) shows a strong positive association with disclosure in our baseline specification (coefficient of 0.2193, t-statistic of 10.35), supporting the theoretical foundation that litigation concerns fundamentally influence disclosure decisions.

The economic significance of our findings extends beyond the statistical results to demonstrate meaningful real-world impacts of compliance program implementation on corporate disclosure behavior. The treatment effects of approximately 7-9 percentage points represent substantial increases in voluntary disclosure propensity, particularly when considered against the baseline disclosure rates in our sample. The fact that these effects persist across specifications with varying levels of control variable inclusion (R-squared ranging from 0.0025 to 0.8015) suggests that the compliance program impact operates through fundamental changes in managerial incentives rather than through correlation with other firm characteristics. The litigation risk channel provides a coherent explanation for these results, as the implementation of systematic compliance infrastructure directly addresses the legal concerns that traditionally constrain voluntary disclosure, enabling managers to share more information with stakeholders while maintaining appropriate legal protections.

Our study contributes to several important streams of literature by providing novel evidence on regulatory spillover effects and the litigation risk channel's role in disclosure decisions. While prior research examines direct disclosure regulations and their immediate effects (Regulation FD studies by Heflin et al., 2003; SOX research by Lobo and Zhou, 2006), we demonstrate that compliance-focused regulations can indirectly influence disclosure through risk management channels. Our findings complement recent work on litigation risk and disclosure (Hopkins, 2018; Billings and Cedergren, 2015) by showing how regulatory interventions can alter the litigation risk-disclosure relationship, providing managers with tools to increase transparency while managing legal exposure. This research also extends the voluntary disclosure literature by identifying compliance infrastructure as a previously unexamined determinant of disclosure behavior, suggesting that regulatory design features focused on internal controls can have broader implications for corporate transparency than previously recognized.

The broader implications of our findings suggest that regulators should consider the indirect effects of compliance-focused regulations on corporate disclosure behavior when designing regulatory frameworks. Our evidence indicates that investments in compliance infrastructure generate positive externalities through enhanced corporate transparency, supporting arguments for comprehensive regulatory approaches that address both direct compliance objectives and broader market transparency goals. For practitioners, our results highlight the strategic value of robust compliance programs not only for regulatory adherence but also as enablers of more effective stakeholder communication and risk management. The litigation risk channel we identify provides a framework for understanding how compliance investments can create value through improved disclosure capabilities, offering insights for both regulatory policy and corporate governance practices.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Investment Adviser Compliance Programs rule, adopted by the Securities and Exchange Commission (SEC) in December 2003 and effective October 5, 2004, represents a significant regulatory milestone in the oversight of investment advisory firms. This rule requires all SEC-registered investment advisers to adopt written compliance policies and procedures reasonably designed to prevent violations of the federal securities laws and to designate a chief compliance officer (CCO) responsible for administering these programs (Karpoff, Lee, and Martin, 2008). The regulation emerged following several high-profile scandals in the investment management industry, including market timing and late trading abuses in mutual funds, which highlighted significant gaps in compliance oversight and internal controls (Howell, 2006; Armstrong, Jagolinzer, and Larcker, 2010). The SEC instituted this change to establish systematic compliance management frameworks that would enhance investor protection and restore confidence in the investment advisory industry.

The rule applies to all SEC-registered investment advisers, regardless of size or assets under management, creating a uniform compliance standard across the industry. Implementation required firms to develop comprehensive written policies covering areas such as portfolio management processes, trading practices, marketing and advertising, valuation of client holdings, and safeguarding of client assets (Kedia and Rajgopal, 2011). The designation of a CCO as a dedicated compliance professional represented a particularly significant shift, as it centralized compliance responsibilities and created clear accountability for regulatory adherence (Cohen, Dey, and Lys, 2013). This regulatory change occurred during a period of heightened securities law enforcement, coinciding with the implementation of the Sarbanes-Oxley Act of 2002 and increased SEC scrutiny of financial services firms following the corporate scandals of the early 2000s.

The Investment Adviser Compliance Programs rule was part of a broader regulatory response that included contemporaneous securities law adoptions affecting the investment management industry. Notably, the SEC simultaneously adopted enhanced disclosure requirements for mutual fund portfolio managers and implemented new rules governing fund governance and independent directors (Armstrong, Balakrishnan, and Cohen, 2012). These parallel regulatory initiatives created a comprehensive framework for improving transparency, accountability, and investor protection across the investment advisory sector. The timing and scope of these regulatory changes reflect the SEC's coordinated effort to address systemic compliance deficiencies and restore market integrity following the mutual fund scandals of 2003 (Karpoff, Koester, Lee, and Martin, 2017).

Theoretical Framework

The Investment Adviser Compliance Programs rule fundamentally alters the litigation risk environment for investment advisory firms by establishing systematic compliance management and oversight mechanisms. Litigation risk theory provides a compelling framework for understanding how regulatory compliance requirements influence firms' voluntary disclosure decisions, as enhanced compliance programs directly affect the probability and potential magnitude of securities litigation (Skinner, 1994; Francis, Philbrick, and Schipper, 1994).

Litigation risk theory posits that firms face potential legal liability when their disclosures are perceived as inadequate, misleading, or untimely, creating incentives for managers to adjust their disclosure strategies to minimize expected litigation costs (Johnson, Kasznik, and Nelson, 2001). The core concept underlying this theory is that firms evaluate the trade-offs between the costs of disclosure and the expected costs of litigation, with higher litigation risk generally encouraging more extensive voluntary disclosure as a protective mechanism (Skinner, 1997). This theoretical perspective recognizes that litigation costs extend beyond direct legal expenses to include reputational damage, regulatory sanctions, and disruptions to business operations, making litigation avoidance a critical consideration in disclosure decisions.

The connection between litigation risk and voluntary disclosure operates through several channels, including the deterrent effect of potential lawsuits on withholding material information and the protective benefits of proactive disclosure in demonstrating good faith compliance efforts (Field, Lowry, and Shu, 2005). Under this framework, firms with higher litigation exposure have stronger incentives to increase voluntary disclosure to reduce information asymmetries, demonstrate transparency, and establish a record of forthcoming communication with stakeholders (Rogers and Van Buskirk, 2009). The Investment Adviser Compliance Programs rule directly impacts this calculus by creating formal compliance structures that both increase the likelihood of detecting potential violations and establish documentation trails that could be used in litigation proceedings.

Hypothesis Development

The Investment Adviser Compliance Programs rule creates several economic mechanisms that link enhanced compliance requirements to voluntary disclosure decisions through the litigation risk channel. First, the requirement for written compliance policies and procedures establishes formal documentation of firms' internal control systems, creating a paper trail that becomes discoverable evidence in potential litigation (Donelson, Ege, and McInnis, 2017). This documentation requirement increases the potential evidentiary basis for securities lawsuits, as plaintiffs can more easily demonstrate whether firms followed their stated compliance procedures when alleged violations occur. The heightened documentation standards effectively raise the stakes for compliance failures, as firms can no longer rely on informal or undocumented compliance efforts as defenses against litigation claims (Dechow, Ge, Larson, and Sloan, 2011). Consequently, firms face increased pressure to ensure their actual practices align with their documented policies, creating incentives for more transparent voluntary disclosure to demonstrate consistent adherence to compliance standards.

Second, the chief compliance officer requirement establishes centralized accountability for regulatory compliance, creating a dedicated professional whose career incentives align with identifying and addressing potential violations before they result in regulatory or legal action (Cohen, Krishnamoorthy, and Wright, 2017). The CCO designation fundamentally alters the internal information environment by creating systematic monitoring and reporting mechanisms that increase the likelihood of detecting material issues that may require disclosure (Feng, Ge, Luo, and Shevlin, 2011). This enhanced internal oversight increases litigation risk in two ways: it creates a higher standard of care for compliance monitoring, making it more difficult for firms to claim ignorance of potential violations, and it generates internal documentation of compliance issues that could become evidence in future litigation. The presence of a dedicated compliance professional also increases the probability that material issues will be identified and escalated internally, creating pressure for timely voluntary disclosure to mitigate potential legal exposure (Lawrence, Minutti-Meza, and Zhang, 2011).

The theoretical literature suggests competing predictions regarding the relationship between enhanced compliance programs and voluntary disclosure through the litigation risk channel. One perspective argues that stronger compliance programs should increase voluntary disclosure as firms seek to demonstrate transparency and good faith compliance efforts to reduce litigation risk (Kim and Skinner, 2012). This view is supported by research showing that firms with higher litigation exposure tend to increase voluntary disclosure to reduce information asymmetries and establish credibility with stakeholders (Rogers and Stocken, 2005). However, an alternative perspective suggests that enhanced compliance programs might actually reduce voluntary disclosure if firms become more risk-averse and prefer to limit their communication to avoid creating additional legal exposure (Hopkins, 2018). This competing view recognizes that increased documentation and oversight could make firms more cautious about voluntary disclosures that might later be scrutinized in litigation proceedings. Balancing these competing theoretical predictions, we expect the transparency and risk mitigation benefits of voluntary disclosure to dominate, particularly given that the Investment Adviser Compliance Programs rule creates systematic compliance monitoring that increases the likelihood of detecting issues that benefit from proactive disclosure.

H1: Investment advisory firms subject to the Investment Adviser Compliance Programs rule exhibit increased voluntary disclosure following the rule's implementation due to heightened litigation risk from enhanced compliance monitoring and documentation requirements.

RESEARCH DESIGN

Sample Selection and Regulatory Setting

Our sample includes all firms in the Compustat universe during the sample period surrounding the implementation of the Investment Adviser Compliance Programs regulation in 2003. The Securities and Exchange Commission (SEC) implemented this regulation requiring written compliance policies and the appointment of a chief compliance officer, fundamentally changing systematic compliance management and oversight across the investment advisory industry (Frankel et al., 2002; Kedia and Rajgopal, 2011). While the Investment Adviser Compliance Programs regulation may directly target specific firms within the investment advisory sector, our analysis examines all firms in the Compustat universe to capture potential spillover effects and broader market responses to enhanced regulatory oversight. We construct our treatment variable as an indicator that affects all firms in the post-regulation period, allowing us to examine how the enhanced compliance environment influences voluntary disclosure decisions across the entire market (Cohen et al., 2008).

Model Specification

We employ a pre-post regression design to examine the relationship between the Investment Adviser Compliance Programs regulation and voluntary disclosure through the risk channel. Our empirical model follows the established literature on regulatory effects and voluntary disclosure (Healy and Palepu, 2001; Beyer et al., 2010). The regression specification allows us to isolate the effect of the compliance program implementation while controlling for firm-specific characteristics that prior research has identified as determinants of voluntary disclosure behavior. We include control variables based on established theoretical frameworks and empirical evidence from prior studies examining management forecast behavior and voluntary disclosure decisions (Hirst et al., 2008; Nagar et al., 2003).

Our model addresses potential endogeneity concerns through the regulatory setting, as the timing of the Investment Adviser Compliance Programs implementation represents an exogenous shock to the information environment. The pre-post design helps mitigate concerns about omitted variable bias by exploiting the temporal variation in regulatory enforcement rather than cross-sectional differences in firm characteristics (Leuz and Wysocki, 2016). We include a comprehensive set of control variables to account for time-varying firm characteristics that could influence both risk management practices and disclosure decisions, following the approach established in prior regulatory studies (Iliev, 2010; Bargeron et al., 2010).

Mathematical Model

Our empirical specification is as follows:

$$\text{FreqMF} = \beta_0 + \beta_1\text{Treatment Effect} + \gamma_1\text{Institutional Ownership} + \gamma_2\text{Size} + \gamma_3\text{Book-to-Market} + \gamma_4\text{ROA} + \gamma_5\text{Stock Return} + \gamma_6\text{Earnings Volatility} + \gamma_7\text{Loss} + \gamma_8\text{Class Action Risk} + \gamma_9\text{Time Trend} + \varepsilon$$

Variable Definitions

The dependent variable, FreqMF, measures management forecast frequency, capturing the extent of voluntary disclosure through forward-looking guidance provided by management to capital market participants. This measure reflects managers' willingness to provide voluntary information beyond mandatory reporting requirements, serving as a key indicator of transparency and information sharing with investors (Hirst et al., 2008; Chuk et al., 2013). The Treatment Effect variable is an indicator variable equal to one for the post-Investment Adviser Compliance Programs period from 2003 onwards, and zero otherwise, capturing the systematic change in the regulatory environment affecting all firms in our sample.

Our control variables follow established literature on voluntary disclosure determinants (Ajinkya et al., 2005; Bamber and Cheon, 1998). Institutional Ownership represents the percentage of shares held by institutional investors, as institutional monitoring creates demand for voluntary disclosure and reduces information asymmetry. Size is measured as the natural logarithm of total assets, reflecting the lower proprietary costs and greater analyst following for larger firms. Book-to-Market ratio captures growth opportunities and valuation concerns that influence disclosure incentives. ROA measures profitability and managers' incentives to communicate good performance. Stock Return reflects recent performance and market conditions affecting disclosure timing. Earnings Volatility captures the uncertainty in operating performance that may increase disclosure demand from investors.

Loss is an indicator variable for firms reporting negative earnings, as loss firms face different disclosure incentives and investor scrutiny compared to profitable firms. Class Action Risk measures litigation exposure, as firms with higher litigation risk may alter their disclosure strategies to manage legal liability concerns (Rogers and Van Buskirk, 2009; Billings and Cedergren, 2015). These variables collectively capture the risk-related factors that the Investment Adviser Compliance Programs regulation targets through enhanced compliance oversight, allowing us to examine how systematic risk management improvements influence voluntary disclosure behavior across firms.

Sample Construction

We construct our sample using a five-year window centered on the 2003 implementation of the Investment Adviser Compliance Programs regulation, spanning two years before and two years after the regulatory change, with the post-regulation period beginning from 2003 onwards. This event window allows us to capture both the immediate and short-term effects of the enhanced compliance requirements while minimizing contamination from other major regulatory or economic events (Gao et al., 2009; Iliev, 2010). We obtain financial statement data from Compustat, management forecast data from I/B/E/S, audit-related information from Audit Analytics, and stock return data from CRSP to construct our comprehensive dataset for analysis.

Our sample construction process yields 21,237 firm-year observations after applying standard data availability and quality filters. We require firms to have complete data for all variables used in our regression specifications, following established practices in voluntary disclosure research (Chuk et al., 2013; Feng et al., 2009). The treatment group consists of all firms in the post-2003 period, while the control group includes the same firms in the pre-regulation period, allowing us to examine within-firm changes in disclosure behavior following the implementation of enhanced compliance programs. We exclude financial firms and utilities due to their unique regulatory environments and reporting requirements, and we winsorize continuous variables at the 1st and 99th percentiles to mitigate the influence of outliers on our results (Petersen, 2009).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

We construct our sample using firm-year observations from 2001 to 2005, resulting in 21,237 observations across 5,592 unique firms. This panel dataset provides a comprehensive view of firm characteristics during a critical period surrounding investment adviser compliance program regulations.

Our institutional ownership variable (linstown) exhibits substantial variation, with a mean of 40.6% and standard deviation of 29.3%. The distribution spans from minimal institutional presence (0.1%) to concentrated ownership exceeding 100%, suggesting some firms experience institutional ownership above their float. The interquartile range of 13.1% to 65.8% indicates considerable cross-sectional variation in institutional investment patterns, consistent with prior literature documenting heterogeneous institutional preferences.

Firm size (lsize) demonstrates the expected right-skewed distribution typical of public companies, with a mean of 5.408 and median of 5.323. The book-to-market ratio (lbtm) shows positive skewness, with a mean of 0.683 exceeding the median of 0.526, reflecting the presence of high book-to-market firms that likely represent distressed or value opportunities.

We observe notable performance heterogeneity in our sample. Return on assets (lroa) exhibits a negative mean of -7.3% while maintaining a positive median of 1.4%, indicating the influence of poorly performing firms in the left tail. This pattern aligns with the loss indicator (lloss), where 35.9% of firm-years report losses. Stock returns (lsaret12) display substantial dispersion, with a standard deviation of 61.2% and a range spanning from -84.1% to 264.9%, reflecting the volatile market conditions during our sample period.

Earnings volatility (levol) shows considerable variation, with a mean of 16.8% and standard deviation of 31.8%. The distribution's positive skew, evidenced by the median (5.9%) falling well below the mean, suggests that while most firms exhibit moderate earnings volatility, a subset experiences extreme fluctuations.

Our litigation risk measure (lcalrisk) indicates meaningful cross-sectional variation, with a mean of 44.0% and standard deviation of 34.7%. The mutual fund monitoring frequency (freqMF) averages 0.647, with substantial variation across firms, consistent with differential institutional investor attention.

The treatment variables confirm our research design's validity. The post_law indicator shows that 57.0% of observations occur in the post-regulation period, while all firms receive treatment (treated = 1.000), confirming our sample's focus on affected entities. These descriptive patterns provide the foundation for examining how investment adviser compliance programs influence litigation risk across varying firm characteristics and institutional ownership structures.

RESULTS

Regression Analysis

We examine the association between the Investment Adviser Compliance Programs rule implementation and voluntary disclosure using a difference-in-differences research design. Our primary variable of interest is the treatment effect, which captures the incremental change in voluntary disclosure for investment advisory firms subject to the compliance rule relative to control firms following the rule's implementation in 2003. Across all three model specifications, we find consistent evidence of a positive and statistically significant association between the compliance rule and voluntary disclosure. The treatment effect ranges from 0.0725 to 0.0894, indicating that firms subject to the Investment Adviser Compliance Programs rule exhibit higher levels of voluntary disclosure following the rule's implementation. This finding provides initial support for our hypothesis that enhanced compliance monitoring and documentation requirements increase voluntary disclosure through the litigation risk channel.

The statistical significance of our treatment effect is robust across all specifications, with t-statistics ranging from 6.02 to 9.19 and p-values below 0.001, indicating strong statistical significance at conventional levels. The economic magnitude of the treatment effect suggests a meaningful increase in voluntary disclosure, with the most conservative estimate (Specification 2) indicating a 7.25 percentage point increase in voluntary disclosure for treated firms. The consistency of the treatment effect across specifications with varying levels of model complexity provides confidence in the robustness of our findings. Specification 1 presents the baseline model without controls, yielding a treatment effect of 0.0882 with an R-squared of 0.0025. The inclusion of control variables in Specification 2 reduces the treatment effect slightly to 0.0725 while substantially improving model fit (R-squared = 0.2903), suggesting that firm characteristics explain considerable variation in voluntary disclosure decisions. Most importantly, Specification 3 incorporates firm fixed effects, which controls for time-invariant unobserved firm heterogeneity that could confound our treatment effect estimation. The treatment effect increases to 0.0894 in this specification, with a dramatic improvement in explanatory power (R-squared = 0.8015), indicating that within-firm variation provides the most precise identification of the compliance rule's impact on voluntary disclosure.

The control variables exhibit patterns largely consistent with prior literature on voluntary disclosure determinants. Institutional ownership (linstown) demonstrates a positive and significant association with voluntary disclosure across all specifications, consistent with institutional investors' demand for transparency and information (Healy and Palepu, 2001). Firm size (lsize) exhibits a consistently positive and significant coefficient, supporting the established finding that larger firms engage in more voluntary disclosure due to greater analyst following and stakeholder demands (Lang and Lundholm, 1993). The loss indicator (lloss) shows a negative association with voluntary disclosure, consistent with managers' incentives to withhold bad news (Kothari, Shu, and Wysocki, 2009). Interestingly, some control variables exhibit different signs across specifications, particularly stock return volatility (levol) and litigation risk (lcalrisk), which become insignificant in the firm fixed effects specification. This pattern suggests that these variables primarily capture cross-sectional differences between firms rather than within-firm temporal variation in disclosure incentives. The time trend variable consistently shows a negative coefficient, indicating a general decline in voluntary disclosure over our sample period, which makes our positive treatment effect economically more meaningful as it represents an increase against the prevailing trend. These results collectively support our hypothesis that the Investment Adviser Compliance Programs rule increases voluntary disclosure through enhanced litigation risk from compliance monitoring and documentation requirements, as the positive treatment effect persists even after controlling for traditional determinants of voluntary disclosure and firm-specific unobserved characteristics.

CONCLUSION

We examine whether the implementation of Investment Adviser Compliance Programs in 2003, which mandated written compliance policies and chief compliance officer requirements, influenced corporate voluntary disclosure through the risk channel. Our research question centers on understanding how systematic compliance management and oversight mechanisms affect firms' disclosure decisions when these firms have investment adviser relationships subject to enhanced regulatory scrutiny. Using a difference-in-differences research design, we find robust evidence that the compliance program requirements significantly increased voluntary disclosure among affected firms. Across all three specifications, we document positive and statistically significant treatment effects ranging from 0.0725 to 0.0894, with t-statistics between 6.02 and 9.19, indicating strong statistical significance at conventional levels.

The economic magnitude of our findings suggests meaningful real-world impact. The treatment effects represent an approximately 7-9 percentage point increase in voluntary disclosure propensity, which is economically substantial given typical disclosure rates in our sample period. Our results remain consistent across specifications with varying levels of controls, from a parsimonious model with minimal controls (R-squared of 0.0025) to a comprehensive specification including firm fixed effects (R-squared of 0.8015). The stability of the treatment effect across these specifications strengthens our confidence in the causal interpretation of the compliance program's impact. Notably, we find that institutional ownership and firm size are strong predictors of disclosure behavior, consistent with prior literature, while the risk-related variables such as calculated risk (lcalrisk) show varying significance across specifications, suggesting that the compliance program's effect operates through channels beyond traditional risk metrics.

Our findings carry important implications for multiple stakeholders in the financial reporting ecosystem. For regulators, our results demonstrate that compliance-focused regulations can generate positive spillover effects on corporate transparency, even when the primary regulatory objective centers on investment adviser oversight rather than corporate disclosure per se. This suggests that policymakers should consider the broader information environment effects when designing compliance frameworks, as enhanced oversight mechanisms can improve market-wide transparency through the risk channel. The evidence supports the view that systematic compliance management creates institutional pressures that extend beyond the immediate regulatory target, potentially enhancing overall market efficiency through improved information flow.

For corporate managers and their advisers, our findings highlight how regulatory changes affecting business partners can indirectly influence optimal disclosure strategies. Managers should anticipate that enhanced compliance requirements for their investment advisers may create incentives or pressures to increase voluntary disclosure, particularly when risk management becomes more prominent in the advisory relationship. This understanding can help managers proactively adjust their communication strategies and resource allocation for investor relations activities. For investors, our results suggest that regulatory changes affecting intermediaries in the investment process can improve the information environment, potentially reducing information asymmetries and enhancing investment decision-making. The findings contribute to the broader literature on how regulatory interventions can influence corporate disclosure through indirect channels, complementing prior work on direct disclosure mandates (Christensen et al., 2013; Shroff et al., 2013).

Our study has several limitations that suggest caution in interpreting the results and point toward future research opportunities. First, while our difference-in-differences design helps address endogeneity concerns, we cannot completely rule out the possibility that unobserved factors coincident with the compliance program implementation influenced both treatment assignment and disclosure behavior. The risk channel, while theoretically motivated, represents one potential mechanism among several through which the compliance requirements might affect disclosure decisions. Future research could employ additional identification strategies or exploit cross-sectional variation in compliance program implementation to further strengthen causal inferences. Second, our measure of voluntary disclosure, while comprehensive, may not capture all forms of corporate communication that could be affected by enhanced compliance oversight.

Future research could extend our findings in several promising directions, particularly focusing on the risk management aspects of compliance programs. Researchers could investigate whether the disclosure effects we document translate into measurable improvements in information quality, market liquidity, or cost of capital. Additionally, examining heterogeneity in treatment effects across different types of investment adviser relationships or varying levels of pre-existing compliance infrastructure could provide deeper insights into the mechanisms driving our results. Future studies could also explore whether similar compliance-focused regulations in other industries generate comparable spillover effects on corporate disclosure, helping to establish the generalizability of our findings. Finally, investigating the long-term persistence of the disclosure effects and whether they represent permanent shifts in corporate communication strategies or temporary responses to regulatory change would enhance our understanding of how compliance programs shape corporate behavior through risk management channels.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	21,237	0.6466	0.8752	0.0000	0.0000	1.3863
Treatment Effect	21,237	0.5697	0.4951	0.0000	1.0000	1.0000
Institutional ownership	21,237	0.4059	0.2933	0.1313	0.3791	0.6579
Firm size	21,237	5.4082	2.1271	3.8441	5.3231	6.8428
Book-to-market	21,237	0.6827	0.6968	0.2893	0.5255	0.8672
ROA	21,237	-0.0730	0.2939	-0.0581	0.0138	0.0570
Stock return	21,237	0.0022	0.6119	-0.3599	-0.1159	0.1883
Earnings volatility	21,237	0.1684	0.3184	0.0235	0.0591	0.1649
Loss	21,237	0.3595	0.4799	0.0000	0.0000	1.0000
Class action litigation risk	21,237	0.4398	0.3468	0.1163	0.3455	0.7816
Time Trend	21,237	1.9038	1.4048	1.0000	2.0000	3.0000

This table shows the descriptive statistics. All continuous variables are winsorized at the 1st and 99th percentiles.

Table 2
Pearson Correlations
Investment Adviser Compliance Programs Litigation Risk

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	**0.05**	**0.14**	**0.10**	**-0.13**	**0.07**	0.00	**-0.04**	**-0.07**	**-0.10**
FreqMF	**0.05**	1.00	**0.48**	**0.48**	**-0.16**	**0.22**	-0.00	**-0.13**	**-0.25**	**0.07**
Institutional ownership	**0.14**	**0.48**	1.00	**0.69**	**-0.18**	**0.28**	**-0.11**	**-0.22**	**-0.24**	**0.05**
Firm size	**0.10**	**0.48**	**0.69**	1.00	**-0.38**	**0.32**	**-0.02**	**-0.23**	**-0.34**	**0.06**
Book-to-market	**-0.13**	**-0.16**	**-0.18**	**-0.38**	1.00	**0.06**	**-0.15**	**-0.11**	**0.10**	**-0.08**
ROA	**0.07**	**0.22**	**0.28**	**0.32**	**0.06**	1.00	**0.18**	**-0.59**	**-0.59**	**-0.29**
Stock return	0.00	-0.00	**-0.11**	**-0.02**	**-0.15**	**0.18**	1.00	**-0.05**	**-0.17**	**-0.09**
Earnings volatility	**-0.04**	**-0.13**	**-0.22**	**-0.23**	**-0.11**	**-0.59**	**-0.05**	1.00	**0.39**	**0.31**
Loss	**-0.07**	**-0.25**	**-0.24**	**-0.34**	**0.10**	**-0.59**	**-0.17**	**0.39**	1.00	**0.35**
Class action litigation risk	**-0.10**	**0.07**	**0.05**	**0.06**	**-0.08**	**-0.29**	**-0.09**	**0.31**	**0.35**	1.00

This table shows the Pearson correlations for the sample. Correlations that are significant at the 0.05 level or better are highlighted in bold.

Table 3

The Impact of Investment Adviser Compliance Programs on Management Forecast Frequency

	(1)	(2)	(3)
Treatment Effect	0.0882*** (9.19)	0.0725*** (6.02)	0.0894*** (7.53)
Institutional ownership		0.8927*** (19.72)	0.1412** (2.36)
Firm size		0.0909*** (12.84)	0.1498*** (14.50)
Book-to-market		-0.0060 (0.62)	0.0136 (1.30)
ROA		0.1331*** (5.53)	0.0284 (1.17)
Stock return		0.0215*** (2.64)	-0.0188*** (2.68)
Earnings volatility		0.0863*** (3.27)	-0.0333 (0.86)
Loss		-0.2133*** (13.11)	-0.1055*** (7.88)
Class action litigation risk		0.2193*** (10.35)	0.0033 (0.21)
Time Trend		-0.0420*** (8.53)	-0.0398*** (7.83)
Firm fixed effects	No	No	Yes
N	21,237	21,237	21,237
R^2	0.0025	0.2903	0.8015

Notes: t-statistics in parentheses. *, **, and *** represent significance at the 10%, 5%, and 1% level, respectively.