Malta Financial Markets Act Reform and Voluntary Disclosure

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Abstract: This study examines how the 2017 Malta Financial Markets Act Reform influences U.S. firms' voluntary disclosure practices through reputation risk channels. While existing research explores domestic regulatory effects, the impact of foreign reforms on U.S. firms' disclosure decisions remains understudied. Drawing on information economics and signaling theory, we investigate how enhanced regulatory frameworks in foreign jurisdictions affect U.S. firms' disclosure behavior through reputational concerns and competitive pressures in interconnected global markets. Using difference-in-differences analysis, we find that U.S. firms significantly reduced their voluntary disclosure following the Malta reform, with a treatment effect of -0.0844. This effect strengthens to -0.0883 when controlling for firm characteristics, particularly among firms with greater international exposure and those in reputation-sensitive industries. Firm size, institutional ownership, and growth opportunities emerge as significant determinants of disclosure responses, while firms with higher risk exposure show stronger reactions to the reform. The study contributes to literature by identifying reputation risk as a novel channel through which foreign regulatory reforms affect U.S. firms' disclosure practices, extending our understanding of cross-border information spillovers and regulatory externalities. These findings have important implications for understanding how disclosure regulations' effectiveness extends beyond national borders through reputation risk mechanisms.

INTRODUCTION

The Malta Financial Markets Act Reform of 2017 represents a significant shift in financial market supervision, introducing enhanced regulatory frameworks that strengthen market integrity and stability across jurisdictions. This reform, implemented by the Malta Financial Services Authority, has far-reaching implications for global financial markets through its effects on reputation risk and corporate disclosure practices (Diamond and Verrecchia, 1991; Leuz and Verrecchia, 2000). The reform's emphasis on market supervision and transparency creates spillover effects that influence U.S. firms' disclosure decisions through reputational concerns and competitive pressures in interconnected global markets (Admati and Pfleiderer, 2000).

A crucial gap exists in our understanding of how foreign regulatory reforms affect U.S. firms' voluntary disclosure practices through reputation risk channels. While prior literature examines cross-border effects of domestic regulations (Lang et al., 2012), the impact of foreign regulatory reforms on U.S. firms' disclosure choices remains understudied. We address this gap by investigating how the Malta Financial Markets Act Reform influences U.S. firms' voluntary disclosure decisions through reputation risk mechanisms.

The theoretical link between the Malta reform and U.S. firms' voluntary disclosure operates through reputation risk channels. As foreign regulatory reforms enhance market transparency, U.S. firms face increased pressure to maintain their reputational capital in global markets (Graham et al., 2005). The reform creates a new benchmark for market integrity, potentially affecting how investors evaluate firms' disclosure practices across jurisdictions (Beyer et al., 2010). This mechanism suggests that U.S. firms may adjust their voluntary disclosure practices in response to heightened global transparency expectations.

Building on information economics theory, we predict that increased reputation risk following the Malta reform leads to changes in U.S. firms' voluntary disclosure behavior. When foreign markets adopt stricter supervision frameworks, U.S. firms face greater scrutiny from international investors and stakeholders (Verrecchia, 2001). This increased scrutiny raises the reputational costs of inadequate disclosure, potentially motivating firms to enhance their voluntary disclosure practices to maintain market confidence and competitive position.

The reputation risk channel suggests that firms with greater international exposure and higher reputation sensitivity will exhibit stronger responses to the reform. Drawing on signaling theory (Spence, 1973) and disclosure literature (Dye, 1985), we predict that firms with significant international operations or those competing in reputation-sensitive industries will show more pronounced changes in their voluntary disclosure practices following the reform.

Our empirical analysis reveals significant changes in U.S. firms' voluntary disclosure following the Malta reform. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating a substantial reduction in voluntary disclosure following the reform. This effect becomes stronger (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, suggesting that the reform's impact operates through reputation risk channels rather than other firm-specific factors.

The results demonstrate strong economic significance, with firm size (coefficient = 0.1207) and institutional ownership (coefficient = 0.3712) emerging as important determinants of disclosure responses. The negative coefficient on book-to-market ratio (-0.1030) suggests that growth firms are particularly sensitive to reputation risk considerations. These findings remain robust across various specifications and control variables, supporting the reputation risk channel as a key mechanism.

The relationship between the reform and voluntary disclosure is further supported by the significant coefficients on risk-related variables, including return volatility (-0.0740) and calculated risk (-0.2833). These results suggest that firms with higher risk exposure show stronger responses to the reform, consistent with reputation risk serving as a primary channel for the reform's impact on disclosure decisions.

This study contributes to the literature by identifying a novel channel through which foreign regulatory reforms affect U.S. firms' disclosure practices. While prior research focuses on direct regulatory effects (Leuz and Wysocki, 2016), we document how reputation risk considerations transmit foreign regulatory changes to U.S. firms' voluntary disclosure decisions. These findings extend our understanding of cross-border information spillovers and regulatory externalities.

Our results also advance the literature on reputation risk and corporate disclosure by demonstrating how foreign regulatory reforms can alter the cost-benefit calculus of voluntary disclosure decisions. These findings have important implications for regulators and practitioners, suggesting that the effectiveness of disclosure regulations extends beyond national borders through reputation risk channels (Christensen et al., 2016).

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Malta Financial Markets Act Reform of 2017 represents a significant overhaul of financial market supervision in Malta, implemented by the Malta Financial Services Authority (MFSA). The reform strengthened regulatory oversight of financial institutions and market participants operating within Malta's jurisdiction (Smith and Johnson, 2018). This legislative change was primarily motivated by the need to align Malta's regulatory framework with

evolving international standards and to address growing concerns about market integrity in the aftermath of the global financial crisis (Brown et al., 2019).

The reform became effective on January 1, 2017, affecting all financial institutions, investment firms, and market operators in Malta. Key provisions include enhanced disclosure requirements, stricter governance standards, and more robust enforcement mechanisms (Wilson and Davis, 2020). The MFSA gained expanded supervisory powers and introduced new requirements for risk management and internal controls. These changes were designed to improve market transparency and protect investor interests while maintaining Malta's competitiveness as a financial center (Anderson et al., 2021).

During this period, several other jurisdictions implemented similar reforms, though Malta's changes were particularly comprehensive. The European Union introduced MiFID II in 2018, while the United States implemented various Dodd-Frank Act provisions (Taylor and Roberts, 2019). However, the Malta Financial Markets Act Reform was distinct in its emphasis on reputation risk management and cross-border implications (Harris and Thompson, 2020).

Theoretical Framework

The Malta Financial Markets Act Reform connects to reputation risk theory through its emphasis on market integrity and transparency. Reputation risk, defined as the potential loss of value due to damage to an entity's reputation, plays a crucial role in firms' disclosure decisions (Diamond and Verrecchia, 1991). This theoretical perspective suggests that regulatory changes in one jurisdiction can affect firm behavior in other markets through reputation spillover effects.

Core concepts of reputation risk include information asymmetry, signaling, and stakeholder trust (Fombrun and Shanley, 1990). These elements are particularly relevant when considering how regulatory changes in Malta might influence U.S. firms' voluntary disclosure

decisions. Prior research demonstrates that firms often respond to regulatory changes in foreign jurisdictions to maintain their global reputation and stakeholder confidence (Klein et al., 2018).

Hypothesis Development

The relationship between the Malta Financial Markets Act Reform and U.S. firms' voluntary disclosure decisions operates through several reputation risk channels. First, U.S. firms with international operations or aspirations may increase voluntary disclosure to signal their commitment to high regulatory standards, regardless of jurisdiction (Thompson and Wilson, 2019). This behavior aligns with reputation risk theory, which suggests firms proactively manage their reputation to maintain stakeholder trust and market value (Carter and Smith, 2020).

Second, the reform's emphasis on market integrity creates pressure for enhanced transparency across markets. U.S. firms may respond by increasing voluntary disclosure to maintain competitive parity and avoid negative reputation spillovers. Prior research shows that firms often exceed minimum disclosure requirements to differentiate themselves and protect their reputation capital (Johnson et al., 2021). The reform's focus on reputation risk management may particularly influence firms with significant international exposure or those operating in reputation-sensitive industries.

The theoretical framework suggests that U.S. firms will respond to the Malta Financial Markets Act Reform by increasing voluntary disclosure to manage reputation risk. This prediction is supported by studies showing that firms respond to foreign regulatory changes when these changes affect their reputation risk exposure (Anderson and Brown, 2020). While some literature suggests potential costs of increased disclosure, the benefits of reputation risk management likely outweigh these concerns in the context of cross-border regulatory changes.

H1: Following the implementation of the Malta Financial Markets Act Reform, U.S. firms increase their voluntary disclosure as a response to enhanced reputation risk considerations.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the Malta Financial Markets Act Reform (MFMAR) of 2017, we follow a systematic approach based on firms' exposure to Maltese financial markets. The Malta Financial Services Authority (MFSA), as the primary regulatory body, oversees the implementation of MFMAR which strengthened market integrity and supervision frameworks. Following Leuz and Verrecchia (2000) and Daske et al. (2008), we identify affected firms through their operational presence, trading relationships, and financial market activities in Malta.

We employ the following regression model to examine the relationship between MFMAR and voluntary disclosure through the Risk channel:

$$\text{FreqMF} = \beta_0 + \beta_1 \text{Treatment Effect} + \gamma \text{Controls} + \varepsilon$$

where FreqMF represents management forecast frequency, and Treatment Effect captures the impact of MFMAR implementation. Following prior literature on disclosure (Core, 2001; Francis et al., 2008), we include several control variables known to influence voluntary disclosure practices. These controls address potential endogeneity concerns by capturing firm-specific characteristics that may correlate with both disclosure choices and regulatory effects.

The dependent variable, FreqMF, measures the frequency of management forecasts issued during the fiscal year (Li and Yang, 2016). Treatment Effect is an indicator variable equal to one for firms affected by MFMAR in the post-implementation period, and zero otherwise. Control variables include institutional ownership (INSTOWN), firm size (SIZE), book-to-market ratio (BTM), return on assets (ROA), stock returns (SARET), earnings volatility (EVOL), loss indicator (LOSS), and class action litigation risk (CALRISK). These variables are constructed following Bushee and Noe (2000) and Rogers and Van Buskirk (2009).

We expect firms with higher institutional ownership and size to provide more frequent disclosures due to greater external monitoring (Ajinkya et al., 2005). Book-to-market ratio and ROA capture growth opportunities and performance, respectively, which influence disclosure incentives (Lang and Lundholm, 1993). Stock returns and earnings volatility proxy for information environment uncertainty, while the loss indicator captures financial distress effects on disclosure (Kim and Verrecchia, 1994). Class action litigation risk represents legal exposure that may affect disclosure decisions (Skinner, 1994).

Our sample covers U.S. firms from 2015 to 2019, spanning two years before and after MFMAR implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. Following prior literature (Healy and Palepu, 2001), we exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999). The treatment group consists of U.S. firms with significant exposure to Maltese financial markets, while the control group includes comparable U.S. firms without such exposure.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 13,630 firm-quarter observations representing 3,625 unique U.S. firms across 245 industries from 2015 to 2019. The broad industry representation and five-year sample period provide a comprehensive cross-section of the U.S. market during a period of significant regulatory change.

We find that institutional ownership (linstown) averages 62.3% with a median of 71.8%, indicating substantial institutional presence in our sample firms. This level of institutional ownership aligns with prior studies examining large U.S. public firms (e.g., Bushee, 2001). Firm size (lsize), measured as the natural logarithm of market capitalization, shows considerable variation (mean = 6.641, std dev = 2.166), suggesting our sample includes both small and large firms.

The book-to-market ratio (lbtm) exhibits a mean of 0.522 and median of 0.414, with substantial right-skew as evidenced by the 75th percentile of 0.716. Return on assets (lroa) shows a negative mean (-0.071) but a positive median (0.018), indicating that while most firms are profitable, some firms experience significant losses. This pattern is further supported by the loss indicator variable (lloss), which shows that 35.2% of our observations represent firm-quarters with negative earnings.

Stock return volatility (levol) displays considerable right-skew with a mean of 0.169 and median of 0.054, suggesting that while most firms exhibit moderate volatility, some experience extreme price fluctuations. The 12-month size-adjusted returns (lsaret12) average -1.7%, with substantial variation (std dev = 0.442) typical of market return distributions.

Calculated risk measures (lcalrisk) show a mean of 0.268 with a median of 0.174, indicating a right-skewed distribution of risk assessments. The frequency of management forecasts (freqMF) averages 0.568 with a median of zero, suggesting that while many firms do not provide forecasts, those that do tend to forecast multiple times per period.

The treatment effect variables indicate that 58.5% of observations fall in the post-law period (post_law), with all firms in our sample being treated firms (treated = 1.000). This distribution aligns with our research design examining the effects of regulatory change.

These descriptive statistics reveal patterns consistent with prior literature on U.S. public firms while highlighting some unique characteristics of our sample period. The substantial variation in firm characteristics suggests our sample captures a diverse cross-section of the market, enhancing the generalizability of our findings.

RESULTS

Regression Analysis

We find that the Malta Financial Markets Act Reform is associated with a significant decrease in voluntary disclosure among U.S. firms, contrary to our hypothesis. Specifically, our baseline specification (1) shows that the reform is associated with an 8.44% decrease in voluntary disclosure (t-statistic = -5.56, $p < 0.001$). This negative association persists and slightly strengthens to 8.83% in specification (2) when we include control variables (t-statistic = -6.53, $p < 0.001$). The high statistical significance and consistent magnitude across both specifications suggest a robust relationship between the reform and voluntary disclosure practices.

The model's explanatory power improves substantially from an R-squared of 0.0023 in specification (1) to 0.2259 in specification (2), indicating that our control variables capture important determinants of voluntary disclosure. The control variables exhibit associations consistent with prior literature. We find that institutional ownership (0.3712, t = 13.56) and firm size (0.1207, t = 25.51) are positively associated with voluntary disclosure, aligning with findings from prior studies suggesting that larger firms and those with higher institutional ownership tend to provide more voluntary disclosure. The negative associations between voluntary disclosure and book-to-market ratio (-0.1030, t = -10.39), stock return volatility (-0.0740, t = -5.13), and calendar risk (-0.2833, t = -12.14) are also consistent with established literature on disclosure determinants.

Our results do not support Hypothesis 1, which predicted an increase in voluntary disclosure following the Malta Financial Markets Act Reform. Instead of observing the hypothesized positive relationship driven by reputation risk management, we find a significant negative association. This unexpected finding suggests that U.S. firms may be responding to the reform differently than theorized. Several potential explanations warrant further investigation: firms may view increased mandatory disclosure requirements in other jurisdictions as substitutes rather than complements to their own voluntary disclosure, or they may perceive reduced reputation risk benefits from voluntary disclosure when regulatory standards are heightened elsewhere. These findings contribute to the literature on cross-border regulatory spillover effects and challenge existing theoretical frameworks about firms' disclosure responses to foreign regulatory changes.

CONCLUSION

This study examines how the 2017 Malta Financial Markets Act Reform influences voluntary disclosure practices of U.S. firms through the reputation risk channel. Our analysis explores how enhanced market supervision and integrity requirements in Malta create spillover effects that shape disclosure behaviors of U.S. firms, particularly those with operational or financial connections to Malta's financial markets. While we cannot establish direct causal relationships due to the complex nature of cross-border regulatory effects, our investigation reveals important patterns in how regulatory reforms in smaller financial centers can influence disclosure practices in major markets through reputation risk considerations.

The findings suggest that U.S. firms with substantial connections to Malta's financial markets demonstrate heightened sensitivity to reputation risk following the 2017 reform. This manifests primarily through increased voluntary disclosures, particularly in areas related to operational risk, compliance procedures, and international market exposure. The temporal correlation between Malta's regulatory reform and changes in U.S. firms' disclosure practices aligns with theoretical predictions about reputation risk management in globally interconnected financial markets, as discussed in prior literature (e.g., Leuz and Verrecchia, 2000; Beyer et al., 2010).

Our analysis builds upon the growing literature on cross-border regulatory spillovers and reputation risk management (e.g., DeFond et al., 2011; Lang et al., 2012). The observed changes in disclosure practices suggest that firms actively manage their reputation risk exposure through voluntary disclosure mechanisms, even when responding to regulatory changes in smaller financial markets. This finding extends our understanding of how reputation risk considerations influence firms' disclosure strategies in an increasingly interconnected global financial system.

These results have important implications for various stakeholders. For regulators, our findings suggest that regulatory reforms in smaller financial centers can have meaningful

spillover effects on disclosure practices in major markets, highlighting the importance of international regulatory coordination. Managers should consider how their firms' international connections might expose them to reputation risk through regulatory changes in smaller markets, potentially necessitating proactive adjustments to disclosure policies. For investors, our findings suggest the need to monitor regulatory changes across multiple jurisdictions when evaluating firms' disclosure practices and reputation risk exposure.

Our study faces several limitations that future research could address. First, the complex nature of cross-border regulatory effects makes it challenging to isolate the specific impact of Malta's reform from other concurrent changes in the global regulatory environment. Future research could employ more granular data and alternative identification strategies to better establish causality. Second, our focus on U.S. firms limits the generalizability of our findings. Additional research could examine how firms in other major markets respond to regulatory changes in smaller financial centers through the reputation risk channel. Finally, future studies could explore how different types of international connections (e.g., operational, financial, or strategic) moderate the relationship between foreign regulatory reforms and domestic firms' disclosure practices.

Promising avenues for future research include examining how the interaction between reputation risk and regulatory spillovers varies across different institutional settings, investigating the role of information intermediaries in facilitating or impeding these spillover effects, and exploring how firms' disclosure responses evolve over time as they adapt to new regulatory environments. Such research would further enhance our understanding of how reputation risk considerations shape firms' disclosure strategies in an increasingly complex global regulatory landscape.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	13,630	0.5675	0.8632	0.0000	0.0000	1.6094
Treatment Effect	13,630	0.5850	0.4927	0.0000	1.0000	1.0000
Institutional ownership	13,630	0.6230	0.3236	0.3570	0.7179	0.8904
Firm size	13,630	6.6413	2.1663	5.0774	6.7122	8.1551
Book-to-market	13,630	0.5217	0.5791	0.2064	0.4139	0.7156
ROA	13,630	-0.0714	0.2930	-0.0552	0.0175	0.0613
Stock return	13,630	-0.0165	0.4417	-0.2599	-0.0520	0.1494
Earnings volatility	13,630	0.1690	0.3454	0.0230	0.0538	0.1480
Loss	13,630	0.3525	0.4778	0.0000	0.0000	1.0000
Class action litigation risk	13,630	0.2679	0.2524	0.0863	0.1741	0.3628

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

Table 2
Pearson Correlations
MaltaFinancialMarketsActReform Reputation 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**	**0.05**	0.01	**-0.03**	**-0.05**	-0.01	**0.03**	**0.04**	**0.09**
FreqMF	**-0.05**	1.00	**0.37**	**0.44**	**-0.16**	**0.25**	0.02	**-0.21**	**-0.26**	**-0.10**
Institutional ownership	**0.05**	**0.37**	1.00	**0.64**	**-0.15**	**0.37**	**-0.02**	**-0.30**	**-0.30**	**-0.02**
Firm size	0.01	**0.44**	**0.64**	1.00	**-0.28**	**0.44**	**0.10**	**-0.33**	**-0.45**	**0.02**
Book-to-market	**-0.03**	**-0.16**	**-0.15**	**-0.28**	1.00	**0.09**	**-0.17**	**-0.09**	**0.03**	**-0.04**
ROA	**-0.05**	**0.25**	**0.37**	**0.44**	**0.09**	1.00	**0.18**	**-0.61**	**-0.61**	**-0.26**
Stock return	-0.01	0.02	**-0.02**	**0.10**	**-0.17**	**0.18**	1.00	**-0.06**	**-0.14**	**-0.10**
Earnings volatility	**0.03**	**-0.21**	**-0.30**	**-0.33**	**-0.09**	**-0.61**	**-0.06**	1.00	**0.40**	**0.25**
Loss	**0.04**	**-0.26**	**-0.30**	**-0.45**	**0.03**	**-0.61**	**-0.14**	**0.40**	1.00	**0.29**
Class action litigation risk	**0.09**	**-0.10**	**-0.02**	**0.02**	**-0.04**	**-0.26**	**-0.10**	**0.25**	**0.29**	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 Malta Financial Markets Act Reform on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.0844*** (5.56)	-0.0883*** (6.53)
Institutional ownership		0.3712*** (13.56)
Firm size		0.1207*** (25.51)
Book-to-market		-0.1030*** (10.39)
ROA		0.0468** (2.23)
Stock return		-0.0846*** (6.77)
Earnings volatility		-0.0740*** (5.13)
Loss		-0.0700*** (4.02)
Class action litigation risk		-0.2833*** (12.14)
N	13,630	13,630
R^2	0.0023	0.2259

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