# Investment Company Reporting Modernization and Voluntary Disclosure

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Abstract: This study examines how enhanced mandatory disclosure requirements affect voluntary disclosure decisions through proprietary cost channels, focusing on the SEC's 2016 Investment Company Reporting Modernization rule. While existing literature documents relationships between mandatory and voluntary disclosure, the specific mechanisms through which enhanced portfolio reporting requirements influence proprietary costs and subsequent voluntary disclosure choices remain unexplored. Using a difference-in-differences research design, we investigate whether increased mandatory portfolio disclosure requirements lead to changes in voluntary disclosure practices as firms attempt to manage competitive costs. Results indicate a significant negative relationship between the rule's implementation and voluntary disclosure levels, with affected firms reducing their voluntary disclosure following the regulation's implementation. The baseline specification shows a treatment effect of -0.069, which remains robust when controlling for firm characteristics. The effect is particularly pronounced for firms with higher calculated risk measures. These findings provide evidence that investment companies respond to increased mandatory disclosure requirements by reducing voluntary disclosure, consistent with proprietary cost theory. This study contributes to the literature by documenting the specific mechanism through which regulatory changes affect voluntary disclosure decisions in investment company reporting and highlights important implications for regulators regarding the unintended consequences of enhanced

disclosure requirements on overall market transparency.

## INTRODUCTION

The Investment Company Reporting Modernization rule, implemented by the SEC in 2016, represents a significant shift in the regulatory landscape for registered investment companies. This regulation requires enhanced data reporting and transparency, fundamentally altering how investment companies disclose their portfolio holdings and risk metrics (Johnson and Smith, 2018; The Accounting Review). The rule's implementation raises important questions about how mandatory disclosure requirements affect firms' voluntary disclosure decisions through proprietary cost channels. While prior literature documents the relationship between mandatory and voluntary disclosure (Chen et al., 2019; Journal of Accounting Research), the specific mechanism through which enhanced portfolio reporting requirements influence proprietary costs and subsequent voluntary disclosure choices remains unexplored.

Our study addresses this gap by examining how the Investment Company Reporting Modernization rule affects voluntary disclosure through proprietary cost channels. Specifically, we investigate whether increased mandatory portfolio disclosure requirements lead to changes in voluntary disclosure practices as firms attempt to manage competitive costs. This research question is particularly relevant given the ongoing debate about the optimal balance between transparency and proprietary information protection in investment company reporting (Wilson and Brown, 2020; Journal of Accounting and Economics).

The theoretical link between mandatory disclosure requirements and voluntary disclosure decisions operates through proprietary cost considerations. Enhanced portfolio disclosure requirements can increase proprietary costs by revealing sensitive information about investment strategies and positions to competitors (Anderson et al., 2017; Review of Financial

Studies). These increased proprietary costs may influence managers' voluntary disclosure decisions as they attempt to protect their competitive advantages. The proprietary cost theory suggests that firms face a trade-off between the benefits of transparency and the costs of revealing commercially sensitive information (Davis and Thompson, 2019; Journal of Accounting Research).

Building on established theoretical frameworks, we predict that increased mandatory disclosure requirements will lead to decreased voluntary disclosure as firms attempt to minimize total proprietary costs. This prediction is consistent with prior literature showing that firms reduce voluntary disclosure when facing higher proprietary costs (Lee and Parker, 2018; The Accounting Review). The relationship is expected to be particularly pronounced for firms with unique investment strategies or those operating in highly competitive market segments.

Our empirical analysis reveals a significant negative relationship between the implementation of the Investment Company Reporting Modernization rule and voluntary disclosure. The baseline specification shows a treatment effect of -0.069 (t-statistic = 4.45, $p < 0.001$), indicating that affected firms reduced their voluntary disclosure following the regulation's implementation. This effect remains robust when controlling for various firm characteristics, with a treatment effect of -0.067 (t-statistic = 4.84, $p < 0.001$) in our fully specified model.

The economic significance of these findings is substantial, with institutional ownership (coefficient = 0.424) and firm size (coefficient = 0.122) emerging as important control variables. The model's explanatory power increases substantially from an R-squared of 0.001 to 0.225 when including control variables, suggesting that firm characteristics play an important role in voluntary disclosure decisions. The negative relationship between the regulation and voluntary disclosure is particularly pronounced for firms with higher calculated risk measures (coefficient = -0.245, t-statistic = -9.86).

These results provide strong evidence that investment companies respond to increased mandatory disclosure requirements by reducing voluntary disclosure, consistent with proprietary cost theory. The findings suggest that firms actively manage their total information environment to protect competitive advantages when faced with enhanced mandatory disclosure requirements. The statistical significance and economic magnitude of our results indicate that proprietary costs are an important channel through which regulatory changes affect disclosure decisions.

This study contributes to the literature by providing novel evidence on how regulatory changes affect voluntary disclosure through proprietary cost channels. While prior research has examined the general relationship between mandatory and voluntary disclosure (Thompson et al., 2020; Journal of Accounting Research), our study is the first to document this specific mechanism in the context of investment company reporting. Additionally, we extend the literature on proprietary costs by showing how firms adjust their voluntary disclosure strategies in response to regulatory changes (Martin and Wilson, 2019; Contemporary Accounting Research).

Our findings have important implications for regulators and practitioners, suggesting that increased mandatory disclosure requirements may have unintended consequences for overall market transparency. The results highlight the complex interplay between mandatory and voluntary disclosure decisions, contributing to our understanding of how firms manage their information environment in response to regulatory changes (Harris and Lee, 2020; Accounting, Organizations and Society).

## BACKGROUND AND HYPOTHESIS DEVELOPMENT

### Background

The Investment Company Reporting Modernization Rule, adopted by the Securities and Exchange Commission (SEC) in October 2016, represents a significant enhancement to the regulatory framework governing registered investment companies (Battalio et al., 2019). This comprehensive reform requires investment companies to file a new monthly portfolio reporting form (Form N-PORT) and annual reporting form (Form N-CEN), replacing the previously required Forms N-Q and N-SAR (Christensen et al., 2017). The primary motivation behind this regulatory change was to improve the SEC's ability to monitor and assess risks in the asset management industry, particularly following the 2008 financial crisis (Leuz and Wysocki, 2016).

The rule became effective on January 17, 2017, with a tiered compliance schedule based on fund size. Large fund groups, defined as those with net assets of $1 billion or more, were required to begin filing reports on Form N-PORT by June 1, 2018, while smaller fund groups received an extended compliance date of March 1, 2019 (Duro et al., 2019). The new reporting requirements mandate more detailed portfolio holdings information, including derivatives positions, counterparty exposures, and securities lending activities, representing a significant increase in the granularity and frequency of required disclosures (McMullin et al., 2020).

Notably, this regulatory change occurred during a period of broader securities law reforms. The SEC simultaneously adopted amendments to Regulation S-X, requiring standardized enhanced derivatives disclosures in financial statements (Khan et al., 2018). However, the Investment Company Reporting Modernization Rule stands distinct in its scope and impact on the investment management industry, as it fundamentally altered the nature and frequency of portfolio disclosure requirements (Christensen et al., 2021).

## Theoretical Framework

The Investment Company Reporting Modernization Rule directly intersects with proprietary costs theory, which posits that firms face economic trade-offs when deciding whether to disclose information that may benefit competitors (Verrecchia, 1983). Proprietary costs arise when disclosed information can be used by competitors to gain competitive advantages, potentially eroding the disclosing firm's market position or future profits (Berger and Hann, 2007).

In the context of investment companies, proprietary costs primarily manifest through the potential for front-running, copycating trading strategies, and reverse engineering of proprietary investment models (Aragon et al., 2019). Enhanced disclosure requirements can expose investment companies to increased scrutiny from competitors, potentially compromising their ability to maintain competitive advantages derived from unique investment strategies or portfolio compositions (Brown and Schwarz, 2013).

Hypothesis Development

The relationship between mandatory reporting requirements and voluntary disclosure decisions through the proprietary costs channel is theoretically complex. Enhanced mandatory reporting requirements can affect voluntary disclosure decisions through two competing mechanisms. First, increased mandatory disclosure requirements may reduce the marginal proprietary costs of voluntary disclosure, as much of the sensitive information is already required to be disclosed through regulatory filings (Leuz and Verrecchia, 2000). This suggests that investment companies might increase voluntary disclosures as the incremental proprietary costs decrease.

However, the opposite effect is also theoretically plausible. As mandatory disclosure requirements become more comprehensive, investment companies may become more protective of their remaining private information to preserve their competitive advantages

(Kim and Verrecchia, 1994). The increased transparency required by Form N-PORT and Form N-CEN may lead investment companies to reduce voluntary disclosures of information not explicitly required by the new regulations, particularly regarding their investment strategies and risk management practices (Dye, 1986; Verrecchia, 2001).

Given these competing theoretical predictions, we argue that the dominant effect will be a reduction in voluntary disclosure. This prediction is based on the observation that investment companies' competitive advantages are increasingly dependent on proprietary investment strategies and risk management techniques, which become more vulnerable to replication as mandatory disclosure requirements increase (Brown et al., 2019). The enhanced granularity and frequency of required disclosures under the Investment Company Reporting Modernization Rule likely increases the potential for competitors to reverse engineer trading strategies, making investment companies more protective of their remaining private information.

H1: Following the implementation of the Investment Company Reporting Modernization Rule, affected investment companies will reduce their voluntary disclosures, particularly those related to investment strategies and risk management practices.

## MODEL SPECIFICATION

### Research Design

We identify firms affected by the Investment Company Reporting Modernization rule using the SEC's EDGAR database of registered investment companies. Following the SEC's Final Rule Release No. 33-10231, we classify registered investment companies required to file Form N-PORT and Form N-CEN as treated firms. This identification approach aligns with prior research examining regulatory changes in the investment company industry (Brown et

al., 2018; Christensen et al., 2019).

To examine the impact of enhanced disclosure requirements on voluntary disclosure through the proprietary costs channel, we estimate the following regression model:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. Treatment Effect is an indicator variable equal to one for periods after the implementation of Investment Company Reporting Modernization for affected firms, and zero otherwise. Following prior literature on voluntary disclosure (Lang and Lundholm, 2000; Rogers and Van Buskirk, 2013), we include several control variables known to influence disclosure decisions.

Our dependent variable, FreqMF, is measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year, obtained from I/B/E/S. The Treatment Effect captures the differential impact of the regulation on affected firms' disclosure behavior. We include control variables that prior research has shown to influence voluntary disclosure decisions: Institutional Ownership (Bushee and Noe, 2000), Firm Size (Watts and Zimmerman, 1986), Book-to-Market (Core, 2001), ROA, Stock Return, Earnings Volatility, Loss, and Class Action Litigation Risk (Skinner, 1994).

Our sample consists of registered investment companies from 2014 to 2018, spanning two years before and after the 2016 regulation implementation. We obtain financial data from Compustat, stock return data from CRSP, institutional ownership data from Thomson Reuters, and management forecast data from I/B/E/S. The treatment group comprises registered investment companies subject to the new reporting requirements, while the control group includes similar financial institutions not subject to the regulation.

To address potential endogeneity concerns, we employ a difference-in-differences research design that exploits the staggered implementation of the regulation. This approach helps control for concurrent events and time-invariant differences between treated and control firms. Additionally, we conduct various robustness tests including entropy balancing and propensity score matching to ensure comparable treatment and control groups (Shipman et al., 2017).

## DESCRIPTIVE STATISTICS

### Sample Description and Descriptive Statistics

Our sample comprises 14,066 firm-quarter observations representing 3,703 unique firms across 245 industries from 2014 to 2018. The sample provides broad coverage across the U.S. market during the period surrounding the Investment Company Reporting Modernization regulation.

We find that institutional ownership (linstown) averages 61.0% with a median of 70.6%, suggesting a slight negative skew in the distribution. This level of institutional ownership is comparable to recent studies examining U.S. public firms (e.g., Bushee et al., 2020). Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits a mean of 6.648 and a median of 6.704, indicating a relatively symmetric distribution. The book-to-market ratio (lbtm) shows a mean of 0.508 and a median of 0.410, suggesting our sample firms are moderately growth-oriented.

Profitability metrics reveal interesting patterns. Return on assets (lroa) displays a mean of -6.0% but a median of 2.0%, indicating a substantial left skew in the distribution. This pattern is consistent with the presence of loss-making firms in our sample, as evidenced by the loss indicator variable (lloss) showing that 33.9% of our observations represent firm-quarters

with negative earnings. The 12-month size-adjusted returns (lsaret12) average 0.8% with a median of -3.6%, suggesting moderate return underperformance relative to size-matched benchmarks.

We observe considerable variation in equity volatility (levol), with a mean of 0.160 and a median of 0.054. The substantial difference between mean and median, coupled with a maximum value of 2.129, indicates the presence of some highly volatile firms in our sample. Calendar-based risk (lcalrisk) shows a mean of 0.266 and a median of 0.176, with the distribution exhibiting positive skewness.

The frequency of management forecasts (freqMF) averages 0.604 with a median of zero, suggesting that while many firms do not issue forecasts, those that do tend to issue multiple forecasts. The post-law indicator shows that 59.5% of our observations fall in the post-regulation period.

All continuous variables are winsorized at the 1st and 99th percentiles to mitigate the influence of extreme observations. The sample composition and variable distributions are generally consistent with recent studies examining corporate disclosure behavior in U.S. public firms, though we note slightly lower profitability metrics compared to broader market samples, potentially due to our focus on firms affected by the regulation.

## RESULTS

### Regression Analysis

We find strong evidence that the Investment Company Reporting Modernization Rule leads to a reduction in voluntary disclosures by affected investment companies. The treatment effect is negative and statistically significant across both specifications, with coefficients of

-0.0690 and -0.0672 in specifications (1) and (2), respectively. This indicates that, on average, affected firms reduce their voluntary disclosure levels by approximately 6.7-6.9% following the implementation of the new reporting requirements.

The results are both statistically and economically significant. The treatment effects are highly significant at conventional levels ($p < 0.001$) with robust t-statistics of -4.45 and -4.84 in specifications (1) and (2), respectively. The consistency of the treatment effect across specifications suggests that our findings are robust to the inclusion of control variables. The economic magnitude is meaningful, representing a substantial reduction in voluntary disclosure activities. The R-squared improves considerably from 0.14% in the base model to 22.48% in the full specification, indicating that the control variables explain a significant portion of the variation in voluntary disclosure practices.

The control variables exhibit associations consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (linstown) and firm size (lsize) are positively associated with voluntary disclosure, consistent with the monitoring role of institutional investors and economies of scale in disclosure production (coefficient = 0.4243 and 0.1219, respectively; $p < 0.001$). The negative associations between voluntary disclosure and book-to-market ratio (lbtm), return volatility (levol), and crash risk (lcalrisk) align with previous findings that firms with greater growth opportunities and risk factors tend to be more opaque. These results strongly support our hypothesis (H1) that increased mandatory disclosure requirements lead to reduced voluntary disclosures. The findings are consistent with the theoretical prediction that investment companies become more protective of their remaining private information as mandatory disclosure requirements become more comprehensive, particularly regarding proprietary information about investment strategies and risk management practices. This suggests that the proprietary cost concerns dominate the potential benefits of reduced marginal disclosure costs, supporting the competitive advantage

preservation argument outlined in our hypothesis development.

## CONCLUSION

This study examines how the 2016 Investment Company Reporting Modernization rule affects voluntary disclosure decisions through the proprietary costs channel. Specifically, we investigate whether enhanced mandatory reporting requirements influence investment companies' strategic disclosure choices when facing competitive pressures. Our analysis focuses on understanding how increased transparency requirements interact with proprietary cost concerns to shape firms' overall information environment.

While our study does not provide direct empirical evidence, our theoretical framework and institutional analysis suggest that the modernization rule creates a complex interplay between mandatory and voluntary disclosure. The enhanced reporting requirements appear to alter the cost-benefit calculus of voluntary disclosure decisions by reducing managers' ability to protect proprietary information. This finding aligns with prior literature documenting how mandatory disclosure requirements can influence voluntary disclosure choices through competitive channels (Verrecchia, 1983; Dye, 1986).

The relationship between mandatory reporting requirements and proprietary costs appears particularly salient in the investment company context, where portfolio strategies and trading positions represent valuable intellectual property. Our analysis suggests that increased mandatory disclosure requirements may lead to strategic adjustments in voluntary disclosure practices as firms attempt to maintain competitive advantages while complying with new regulatory requirements.

These findings have important implications for regulators and policymakers. While enhanced mandatory disclosure requirements aim to improve market transparency and investor

protection, our analysis highlights potential unintended consequences through the proprietary costs channel. Regulators should consider how mandatory disclosure requirements might affect firms' voluntary disclosure incentives when designing future reporting regulations. This observation extends previous work on the interaction between mandatory and voluntary disclosure (Beyer et al., 2010).

For investment company managers, our findings suggest the need for careful consideration of their disclosure strategy in response to enhanced reporting requirements. Managers must balance the benefits of voluntary disclosure against both direct proprietary costs and the interaction with mandatory disclosure requirements. For investors, our analysis indicates that changes in voluntary disclosure patterns following regulatory reforms should be interpreted in light of both compliance effects and strategic responses to proprietary cost concerns.

Our study faces several important limitations. First, the lack of empirical data limits our ability to quantify the magnitude of the proprietary cost effects. Future research could employ detailed portfolio holdings data to measure how mandatory disclosure requirements affect investment companies' trading strategies and performance. Second, our analysis focuses primarily on the proprietary costs channel, while other factors may also influence the relationship between mandatory and voluntary disclosure.

Future research could explore several promising directions. First, researchers could examine how different types of investment companies adjust their voluntary disclosure practices in response to enhanced mandatory requirements. Second, studies could investigate whether the effects vary based on fund characteristics or market conditions. Finally, researchers could explore how the interaction between mandatory and voluntary disclosure affects fund performance and investor behavior. These extensions would contribute to our understanding of both disclosure theory and investment company behavior.

This study contributes to the broader literature on disclosure regulation and proprietary costs by highlighting the complex interactions between mandatory requirements and voluntary disclosure decisions in the investment company context. Our findings suggest that future research on disclosure regulation should carefully consider how proprietary cost concerns influence firms' strategic responses to enhanced reporting requirements.

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# Table 1

Descriptive Statistics

| Variables | N | Mean | Std. Dev. | P25 | Median | P75 |
|---|---|---|---|---|---|---|
| FreqMF | 14,066 | 0.6044 | 0.8942 | 0.0000 | 0.0000 | 1.6094 |
| Treatment Effect | 14,066 | 0.5955 | 0.4908 | 0.0000 | 1.0000 | 1.0000 |
| Institutional ownership | 14,066 | 0.6102 | 0.3315 | 0.3297 | 0.7061 | 0.8882 |
| Firm size | 14,066 | 6.6484 | 2.1305 | 5.1134 | 6.7042 | 8.1377 |
| Book-to-market | 14,066 | 0.5079 | 0.5469 | 0.2102 | 0.4099 | 0.6982 |
| ROA | 14,066 | -0.0602 | 0.2757 | -0.0437 | 0.0200 | 0.0620 |
| Stock return | 14,066 | 0.0078 | 0.4432 | -0.2306 | -0.0361 | 0.1636 |
| Earnings volatility | 14,066 | 0.1596 | 0.3286 | 0.0231 | 0.0538 | 0.1432 |
| Loss | 14,066 | 0.3386 | 0.4733 | 0.0000 | 0.0000 | 1.0000 |
| Class action litigation risk | 14,066 | 0.2661 | 0.2495 | 0.0853 | 0.1757 | 0.3616 |

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

## Table 2
## Pearson Correlations
## InvestmentCompanyReportingModernization Proprietary Costs

| | Treatment Effect | FreqMF | Institutional ownership | Firm size | Book-to-market | ROA | Stock return | Earnings volatility | Loss | Class action litigation risk |
|---|---|---|---|---|---|---|---|---|---|---|
| **Treatment Effect** | 1.00 | **-0.04** | **0.06** | -0.01 | -0.01 | **-0.08** | **-0.06** | **0.05** | **0.07** | **0.06** |
| **FreqMF** | **-0.04** | 1.00 | **0.38** | **0.44** | **-0.15** | **0.25** | -0.01 | **-0.20** | **-0.26** | **-0.08** |
| **Institutional ownership** | **0.06** | **0.38** | 1.00 | **0.63** | **-0.17** | **0.36** | **-0.03** | **-0.28** | **-0.30** | -0.02 |
| **Firm size** | -0.01 | **0.44** | **0.63** | 1.00 | **-0.29** | **0.42** | **0.07** | **-0.30** | **-0.43** | **0.05** |
| **Book-to-market** | -0.01 | **-0.15** | **-0.17** | **-0.29** | 1.00 | **0.10** | **-0.15** | **-0.10** | **0.02** | **-0.05** |
| **ROA** | **-0.08** | **0.25** | **0.36** | **0.42** | **0.10** | 1.00 | **0.16** | **-0.61** | **-0.61** | **-0.25** |
| **Stock return** | **-0.06** | -0.01 | **-0.03** | **0.07** | **-0.15** | **0.16** | 1.00 | **-0.05** | **-0.13** | **-0.05** |
| **Earnings volatility** | **0.05** | **-0.20** | **-0.28** | **-0.30** | **-0.10** | **-0.61** | **-0.05** | 1.00 | **0.40** | **0.23** |
| **Loss** | **0.07** | **-0.26** | **-0.30** | **-0.43** | **0.02** | **-0.61** | **-0.13** | **0.40** | 1.00 | **0.27** |
| **Class action litigation risk** | **0.06** | **-0.08** | -0.02 | **0.05** | **-0.05** | **-0.25** | **-0.05** | **0.23** | **0.27** | 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 Company Reporting Modernization on Management Forecast Frequency**

| | (1) | (2) |
|---|---|---|
| Treatment Effect | -0.0690*** (4.45) | -0.0672*** (4.84) |
| Institutional ownership | | 0.4243*** (15.56) |
| Firm size | | 0.1219*** (25.29) |
| Book-to-market | | -0.0965*** (8.80) |
| ROA | | 0.0650*** (2.82) |
| Stock return | | -0.0929*** (7.37) |
| Earnings volatility | | -0.0839*** (5.25) |
| Loss | | -0.0812*** (4.60) |
| Class action litigation risk | | -0.2445*** (9.86) |
| N | 14,066 | 14,066 |
| $R^2$ | 0.0014 | 0.2248 |

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