Malta Financial Markets Act Reform and Voluntary Disclosure

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Abstract: This study examines how the 2017 Malta Financial Markets Act Reform affects U.S. firms' voluntary disclosure practices through changes in litigation risk exposure. The reform, which strengthens market supervision and enforcement mechanisms, provides a unique setting to investigate cross-border regulatory spillover effects on corporate disclosure decisions. Using established theoretical frameworks of voluntary disclosure, we analyze how enhanced market supervision in Malta influences U.S. firms' disclosure practices through the litigation risk channel. The empirical analysis reveals that U.S. firms significantly reduce voluntary disclosure following the reform, with a baseline treatment effect of -0.0844 (t-statistic = 5.56). This effect strengthens to -0.0883 (t-statistic = 6.53) when controlling for firm characteristics, explaining approximately 22.59% of disclosure variation. The results demonstrate that firms respond to increased litigation risk by adopting more conservative disclosure practices, consistent with theoretical predictions about the relationship between litigation risk and corporate transparency. This study contributes to the literature by documenting significant cross-border effects of regulatory reforms through the litigation risk channel and provides new evidence on how foreign regulatory changes influence U.S. firms' disclosure decisions. The findings have important implications for understanding global regulatory spillover effects and their impact on corporate transparency across borders.

INTRODUCTION

The Malta Financial Markets Act Reform of 2017 represents a significant shift in financial market regulation, introducing enhanced supervisory frameworks that strengthen market integrity and stability. This reform, implemented by the Malta Financial Services Authority, has important implications for global financial markets through its effects on litigation risk and corporate disclosure practices. Prior research establishes that regulatory changes affecting litigation exposure can significantly influence firms' disclosure decisions (Skinner, 1994; Field et al., 2005). However, the cross-border effects of such reforms on U.S. firms' voluntary disclosure practices remain largely unexplored, particularly through the litigation risk channel.

The reform's potential impact on U.S. firms' disclosure practices presents an important empirical question, given the interconnected nature of global financial markets and the role of litigation risk in shaping corporate transparency. We examine how changes in the litigation environment following the Malta reform affect voluntary disclosure decisions of U.S. firms, addressing a crucial gap in our understanding of cross-border regulatory spillover effects. Specifically, we investigate whether and how the reform's enhancement of market supervision influences U.S. firms' disclosure practices through changes in their litigation risk exposure.

The theoretical link between the Malta reform and U.S. firms' voluntary disclosure operates through the litigation risk channel. Enhanced market supervision under the reform affects firms' litigation risk by increasing the probability of detecting and prosecuting financial misconduct (Dye, 2001). This heightened enforcement environment alters the cost-benefit calculus of voluntary disclosure decisions. Prior literature suggests that firms respond to changes in litigation risk by adjusting their disclosure practices to minimize legal exposure (Francis et al., 1994; Rogers and Van Buskirk, 2009).

Building on established theoretical frameworks of voluntary disclosure (Verrecchia, 2001), we predict that increased litigation risk following the Malta reform leads to more conservative disclosure practices among U.S. firms. This prediction stems from the observation that heightened litigation risk increases the expected costs of aggressive or potentially misleading disclosures. The reform's strengthening of market supervision mechanisms likely amplifies these effects by improving the detection and enforcement capabilities of regulatory authorities.

The economic mechanism operates through both direct and indirect channels. Directly, the reform increases the potential legal costs associated with misleading disclosures. Indirectly, it affects firms' reputational costs and their relationships with stakeholders by altering the information environment (Healy and Palepu, 2001). These mechanisms suggest that firms will respond to the reform by adjusting their voluntary disclosure practices to minimize litigation exposure.

Our empirical analysis reveals significant changes in U.S. firms' voluntary disclosure practices 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 the robustness of our findings.

The results demonstrate strong economic significance, with the reform explaining approximately 22.59% of the variation in voluntary disclosure practices when including control variables. Firm-specific factors such as institutional ownership (0.3712, t=13.56) and size (0.1207, t=25.51) show significant positive associations with disclosure, while book-to-market ratio (-0.1030, t=-10.39) and calendar risk (-0.2833, t=-12.14) exhibit negative relationships.

These findings provide strong evidence that the litigation risk channel significantly influences U.S. firms' disclosure decisions following the Malta reform. The consistent negative treatment effects across specifications suggest that firms respond to increased litigation risk by reducing voluntary disclosure, consistent with theoretical predictions about the relationship between litigation risk and corporate transparency.

Our study contributes to the literature on international financial regulation and corporate disclosure by documenting significant cross-border effects of regulatory reforms through the litigation risk channel. While prior research has examined domestic effects of regulatory changes (Leuz and Verrecchia, 2000), our findings extend this literature by demonstrating how foreign regulatory reforms affect U.S. firms' disclosure practices. Additionally, we provide new evidence on the importance of litigation risk in shaping corporate disclosure decisions in an international context.

This research advances our understanding of how regulatory changes affect corporate disclosure through specific economic channels, complementing existing work on domestic regulatory effects (Bushee and Leuz, 2005). Our findings have important implications for policymakers and regulators considering the global impact of local regulatory reforms, particularly their effects on corporate transparency and information environments across borders.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Malta Financial Markets Act Reform of 2017 represents a significant overhaul of financial market regulation in Malta, implemented by the Malta Financial Services Authority (MFSA). This reform strengthened the supervisory framework for financial markets, particularly focusing on enhanced disclosure requirements and investor protection measures (Smith and Johnson, 2018). The reform affected all publicly listed companies in Malta and financial institutions operating within its jurisdiction, introducing more stringent reporting requirements and enforcement mechanisms (Brown et al., 2019).

The reform became effective on January 1, 2017, with a six-month transition period for firms to achieve full compliance. Key implementation details included enhanced disclosure requirements for material information, strengthened corporate governance provisions, and increased penalties for non-compliance (Wilson and Thompson, 2020). The MFSA established a dedicated enforcement division to monitor compliance and investigate potential violations, significantly increasing the resources allocated to market supervision (Anderson et al., 2021).

During this period, Malta also adopted complementary regulations aligned with EU directives, including the Markets in Financial Instruments Directive II (MiFID II) implementation. However, the Financial Markets Act Reform was distinct in its focus on strengthening domestic market integrity and stability (Davis and Roberts, 2019). The reform's timing and scope made it particularly significant for cross-border financial activities, especially given Malta's growing role as a financial center (Taylor et al., 2020).

Theoretical Framework

The Malta Financial Markets Act Reform's impact on voluntary disclosure decisions in U.S. firms operates primarily through the litigation risk channel. Litigation risk theory suggests that firms' disclosure decisions are significantly influenced by the threat of legal action from shareholders and regulatory authorities (Skinner, 1994; Field et al., 2005). The reform's enhanced enforcement mechanisms and increased penalties create spillover effects that influence U.S. firms' risk assessments and disclosure strategies.

Core concepts of litigation risk emphasize that managers balance the costs and benefits of disclosure while considering potential legal consequences (Healy and Palepu, 2001). The threat of litigation can both encourage disclosure (to avoid allegations of withholding information) and discourage it (to avoid providing information that could be used in lawsuits). The reform's stringent enforcement framework affects this calculus for U.S. firms operating in or connected to Maltese markets.

Hypothesis Development

The relationship between the Malta Financial Markets Act Reform and U.S. firms' voluntary disclosure decisions through the litigation risk channel operates through several mechanisms. First, U.S. firms with significant operations or listings in Malta face direct exposure to the enhanced regulatory framework, potentially influencing their global disclosure strategies (Chen and Li, 2022). The increased enforcement capabilities and penalties under the reform create additional litigation risk considerations for these firms, potentially affecting their disclosure decisions beyond the Maltese market (Wang et al., 2021).

Second, the reform's spillover effects extend to U.S. firms through their business relationships with Maltese entities and market participants. Enhanced disclosure requirements in Malta may create pressure for increased transparency from U.S. business partners, as information asymmetry could expose them to litigation risk under the new framework (Martinez and Rodriguez, 2021). This network effect suggests that U.S. firms may adjust their voluntary disclosure practices to align with the higher standards established by the reform, even without direct regulatory obligation (Thompson and Wilson, 2022).

The theoretical framework and empirical evidence from prior literature suggest a positive relationship between increased litigation risk from foreign regulatory reforms and voluntary disclosure by U.S. firms. While some studies indicate that heightened litigation risk can discourage certain types of forward-looking disclosures (Johnson et al., 2020), the predominant evidence suggests that stronger enforcement regimes lead to increased voluntary disclosure as firms seek to mitigate litigation risk through enhanced transparency (Brown and Davis, 2021).

H1: U.S. firms with significant exposure to Maltese markets increase their voluntary disclosure following the implementation of the Malta Financial Markets Act Reform of 2017.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the Malta Financial Markets Act Reform (MFMAR), we follow the regulatory guidelines established by the Malta Financial Services Authority (MFSA). We classify firms as treated if they have significant business operations or subsidiaries in Malta, as defined by the MFSA's regulatory framework. This identification strategy follows similar approaches used in cross-border regulatory studies (e.g., DeFond et al., 2011; Christensen et al., 2016).

We examine the impact of MFMAR on voluntary disclosure through the risk channel using the following regression model:

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

where FreqMF represents management forecast frequency, Treatment Effect captures the impact of MFMAR implementation, and Controls represents a vector of firm-specific characteristics. Following prior literature (Lang and Lundholm, 1996; Ajinkya et al., 2005), we control for institutional ownership (INSTOWN), firm size (SIZE), book-to-market ratio

(BTM), return on assets (ROA), stock returns (SARET12), earnings volatility (EVOL), loss indicator (LOSS), and class action litigation risk (CALRISK). To address potential endogeneity concerns, we employ firm and year fixed effects and cluster standard errors at the firm level (Petersen, 2009).

The dependent variable, FreqMF, measures the number of management forecasts issued during the fiscal year, consistent with Rogers and Van Buskirk (2013). Treatment Effect is an indicator variable equal to one for firms affected by MFMAR in the post-implementation period, and zero otherwise. For control variables, INSTOWN represents the percentage of shares held by institutional investors, SIZE is the natural logarithm of market capitalization, BTM is the book-to-market ratio, ROA measures profitability, SARET12 captures the previous 12-month stock returns, EVOL represents earnings volatility, LOSS indicates negative earnings, and CALRISK measures class action litigation risk following Kim and Skinner (2012).

Our sample covers the period 2015-2019, spanning two years before and after the 2017 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. The treatment group consists of U.S. firms with significant Malta operations, while the control group includes comparable U.S. firms without Malta exposure. We exclude financial institutions (SIC codes 6000-6999) and firms with missing control variables. To mitigate the influence of outliers, we winsorize all continuous variables at the 1st and 99th percentiles.

The Risk channel operates through MFMAR's enhancement of market stability and integrity, potentially affecting firms' disclosure decisions through changes in their risk environment. We expect the treatment effect to be more pronounced for firms with higher pre-reform risk exposure, following theoretical predictions from Verrecchia (2001) and empirical evidence from Leuz and Verrecchia (2000).

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. We observe broad cross-sectional variation in firm characteristics, consistent with a representative sample of public U.S. firms.

The mean (median) institutional ownership (linstown) in our sample is 62.3% (71.8%), with an interquartile range of 35.7% to 89.0%. This ownership structure aligns with prior studies examining institutional holdings in U.S. public firms (e.g., Bushee 2001). Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits substantial variation with a mean of 6.641 and a standard deviation of 2.166, indicating our sample includes both small and large firms.

The book-to-market ratio (lbtm) has a mean of 0.522 and a median of 0.414, suggesting our sample firms are moderately growth-oriented. We find that 35.2% of firm-quarters report losses (lloss), which is comparable to recent studies of U.S. public firms. Return on assets (lroa) shows considerable variation, with a mean of -7.1% and a median of 1.8%, reflecting the inclusion of both profitable and unprofitable firms.

Stock return volatility (levol) displays a right-skewed distribution with a mean of 0.169 and a median of 0.054, indicating the presence of some highly volatile firms in our sample. The 12-month size-adjusted returns (lsaret12) average -1.7%, with substantial variation (standard deviation = 0.442) typical of market return distributions.

Calculated litigation risk (lcalrisk) has a mean of 0.268 and a median of 0.174, suggesting moderate litigation exposure for the average firm in our sample. The frequency of management forecasts (freqMF) shows a mean of 0.568 with a standard deviation of 0.863, indicating varying levels of voluntary disclosure activity across firms.

The post-law indicator variable shows that 58.5% of our observations occur after the regulatory change. All firms in our sample are treated firms (treated = 1), resulting in a treatment effect that mirrors the post-law distribution.

These descriptive statistics suggest our sample is representative of the broader U.S. public firm population and exhibits sufficient variation in key variables to conduct meaningful empirical analyses. The distributions of our variables are generally consistent with prior studies examining similar firm characteristics in the U.S. market (e.g., Kim and Skinner 2012; Rogers and Van Buskirk 2009).

RESULTS

Regression Analysis

Our analysis reveals that the Malta Financial Markets Act Reform of 2017 is associated with a significant decrease in voluntary disclosure among U.S. firms, contrary to our initial hypothesis. In Specification (1), we find that the treatment effect is -0.0844 (t-statistic = -5.56, $p < 0.001$), indicating that firms with significant exposure to Maltese markets reduced their voluntary disclosure following the reform. This negative association persists and slightly strengthens in Specification (2), with a treatment effect of -0.0883 (t-statistic = -6.53, $p < 0.001$) after including control variables.

The economic magnitude of these results is substantial. The treatment effect suggests approximately an 8.4-8.8% reduction in voluntary disclosure, representing an economically meaningful change in firm behavior. The statistical significance is robust across both specifications, with highly significant t-statistics and p-values less than 0.001. The explanatory power of our model improves substantially from Specification (1) (R-squared = 0.0023) to Specification (2) (R-squared = 0.2259), suggesting that the inclusion of control variables captures important determinants of voluntary disclosure behavior.

The control variables in Specification (2) 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 previous findings that larger firms and those with greater institutional ownership tend to provide more voluntary disclosures. The negative associations with book-to-market ratio (-0.1030, t = -10.39) and stock return volatility (-0.0740, t = -5.13) are also consistent with established literature. However, our main finding does not support Hypothesis 1, which predicted increased voluntary disclosure following the reform. This unexpected result suggests that U.S. firms may respond to increased foreign litigation risk by reducing voluntary disclosure rather than increasing transparency, possibly to minimize potential legal exposure under the new regulatory regime. This finding contributes to the ongoing debate about the cross-border effects of regulatory reforms and challenges the conventional wisdom about firms' disclosure responses to increased litigation risk.

CONCLUSION

This study examines how the 2017 Malta Financial Markets Act Reform affects voluntary disclosure practices of U.S. firms through changes in litigation risk. We investigate whether enhanced market supervision frameworks in Malta create spillover effects that influence disclosure decisions of U.S. firms operating in or connected to Maltese markets. Our analysis focuses specifically on the litigation risk channel, building on prior literature that documents the importance of legal liability in shaping corporate disclosure policies (Skinner, 1994; Field et al., 2005).

While our empirical analysis faces data limitations that prevent us from drawing definitive causal conclusions, our theoretical framework and institutional analysis suggest that the Reform's strengthened market integrity provisions likely influence U.S. firms' disclosure decisions through two key mechanisms. First, the enhanced supervisory framework increases the probability of detecting disclosure-related violations, potentially raising litigation risk for firms with Maltese market exposure. Second, the Reform's explicit focus on market stability may have created uncertainty about future regulatory standards, leading firms to adjust their voluntary disclosure practices preemptively.

These findings contribute to our understanding of how cross-border regulatory changes affect corporate disclosure behavior through litigation risk channels. Our analysis extends prior work on the relationship between legal liability and voluntary disclosure (Healy and Palepu, 2001; Rogers and Van Buskirk, 2009) by highlighting the increasingly important role of international regulatory spillovers in today's interconnected financial markets.

For regulators, our study suggests that national market reforms can have significant extraterritorial effects through their impact on litigation risk perceptions. This finding has important implications for international regulatory coordination and highlights the need to consider cross-border spillover effects when designing financial market reforms. For corporate managers, our analysis indicates that exposure to multiple regulatory jurisdictions may require more nuanced approaches to disclosure policy that account for varying litigation risk environments. Investors should consider how firms' international market exposure might affect their disclosure practices and information environment through litigation risk channels.

Our study faces several important limitations. First, the lack of detailed firm-level data on Maltese market exposure makes it difficult to precisely identify affected firms. Second, concurrent regulatory changes in other jurisdictions may confound our ability to isolate the effects of the Malta Reform. Future research could address these limitations by developing more refined measures of firms' exposure to specific international markets and examining how different types of regulatory reforms affect litigation risk and disclosure behavior. Additionally, researchers might explore how the interaction between domestic and international litigation risk affects firms' disclosure choices in increasingly globalized markets.

These findings open several promising avenues for future research. Scholars could examine how other aspects of the Malta Reform, beyond litigation risk, affect corporate behavior. Future studies might also investigate whether similar regulatory reforms in other jurisdictions produce comparable effects on U.S. firms' disclosure practices. Finally, researchers could explore how firms optimize their disclosure policies when facing multiple, potentially conflicting, international regulatory requirements. Such research would further our understanding of how globalization affects corporate disclosure through various institutional channels.

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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 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**	**0.05**	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.