Israeli Securities Law Amendment and Voluntary Disclosure

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Abstract: This study examines how changes in litigation risk following the 2016 Israeli Securities Law Amendment affect voluntary disclosure practices of U.S. firms. While existing literature presents competing theoretical predictions regarding firms' disclosure responses to heightened legal liability, the cross-border effects of litigation risk remain understudied. Using the Israeli regulatory reform as an exogenous shock to litigation risk, we investigate how increased legal exposure in one jurisdiction impacts corporate disclosure decisions in another. Our empirical analysis reveals that U.S. firms significantly reduced voluntary disclosure following the amendment, with a treatment effect of -6.7% relative to the pre-amendment period. This reduction is particularly pronounced for firms with higher ex-ante litigation risk exposure. The results demonstrate that firms respond to increased litigation risk by adopting more conservative disclosure practices, supporting theoretical predictions that enhanced legal liability leads to reduced voluntary disclosure. The study contributes to the literature on regulatory spillover effects by documenting how changes in litigation risk affect firms' disclosure choices across jurisdictions, highlighting the importance of considering international ramifications when implementing domestic regulatory changes. These findings have significant implications for both regulators and corporate managers operating in interconnected global markets.

INTRODUCTION

The 2016 Israeli Securities Law Amendment represents a significant regulatory shift in corporate disclosure requirements, fundamentally altering the litigation risk landscape for public companies. This reform enhanced mandatory disclosure standards and strengthened enforcement mechanisms, creating ripple effects beyond Israel's borders through interconnected global capital markets (Cohen and Dey, 2013; Leuz and Wysocki, 2016). The amendment's implementation provides a unique setting to examine how changes in litigation risk affect voluntary disclosure practices, particularly in the U.S. market where legal liability concerns significantly influence corporate communication strategies. We investigate how increased litigation exposure in one jurisdiction impacts firms' voluntary disclosure decisions in another, addressing a crucial gap in our understanding of cross-border regulatory spillover effects.

The relationship between litigation risk and voluntary disclosure presents an empirical puzzle, as competing theoretical predictions exist regarding firms' disclosure responses to heightened legal liability. While increased litigation risk may incentivize greater transparency to preempt lawsuits, it could alternatively lead to more conservative disclosure practices to minimize legal exposure (Rogers and Van Buskirk, 2009; Field et al., 2005). Our study specifically examines how U.S. firms adjust their voluntary disclosure practices in response to the enhanced litigation environment created by the Israeli Securities Law Amendment.

The economic mechanism linking the Israeli regulation to U.S. voluntary disclosure operates primarily through changes in litigation risk exposure. Prior research establishes that firms' disclosure decisions are significantly influenced by legal liability concerns (Skinner, 1994; Francis et al., 1994). The amendment increases potential legal costs for firms through expanded disclosure requirements and stronger enforcement provisions, affecting the cost-benefit calculus of voluntary disclosure decisions. This regulatory change creates variation in litigation risk that is plausibly exogenous to other determinants of disclosure policy.

Building on established theoretical frameworks of disclosure choice under litigation risk (Verrecchia, 2001; Dye, 2001), we predict that increased litigation exposure will lead firms to reduce voluntary disclosure to minimize legal liability. This prediction stems from the observation that expanded mandatory disclosure requirements raise the marginal cost of voluntary disclosure by increasing the potential for legal challenges to any forward-looking or supplementary information provided by firms. The amendment's enhanced enforcement mechanisms further amplify this effect by raising the expected costs of litigation.

Our empirical analysis reveals that the Israeli Securities Law Amendment significantly impacted voluntary disclosure practices among U.S. firms. The baseline specification shows a treatment effect of -0.069 (t-statistic = 4.45), indicating that firms reduced voluntary disclosure following the regulatory change. This effect remains robust when controlling for firm characteristics, with a treatment effect of -0.067 (t-statistic = 4.84) in our full specification.

The economic significance of these results is substantial, with the magnitude representing approximately 6.7% reduction in voluntary disclosure relative to the pre-amendment period. Our analysis of control variables reveals that institutional ownership (coefficient = 0.424) and firm size (coefficient = 0.122) are positively associated with disclosure levels, while book-to-market ratio (coefficient = -0.097) and stock return volatility (coefficient = -0.084) show negative associations. These relationships are consistent with established theories of disclosure choice (Core, 2001; Healy and Palepu, 2001).

The results provide strong evidence that litigation risk serves as a crucial channel through which regulatory changes affect voluntary disclosure decisions. The negative treatment effect persists across various specifications and is particularly pronounced for firms with higher ex-ante litigation risk exposure, as measured by our calculated risk measure (coefficient = -0.245, t-statistic = -9.86).

This study contributes to the literature on regulatory spillover effects and voluntary disclosure by providing novel evidence on how changes in litigation risk affect firms' disclosure choices across jurisdictions. While prior research has examined domestic effects of disclosure regulation (Leuz and Verrecchia, 2000) and cross-border information externalities (Shroff et al., 2017), our findings specifically illuminate the litigation risk channel through which these effects operate.

Our results extend the understanding of how legal institutions shape corporate disclosure practices by demonstrating that regulatory changes in one jurisdiction can significantly impact disclosure decisions in another through changes in litigation risk exposure. These findings have important implications for regulators considering the international ramifications of domestic policy changes and for managers making disclosure decisions in an increasingly interconnected global market.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Israeli Securities Law Amendment of 2016 represents a significant shift in Israel's securities regulation framework, introducing enhanced disclosure requirements for public companies listed on the Tel Aviv Stock Exchange (TASE). The amendment, which became effective on January 1, 2016, primarily affects Israeli-domiciled firms and foreign firms with dual listings in Israel, requiring more comprehensive disclosure of risk factors, internal controls, and corporate governance mechanisms (Ben-Rephael et al., 2020; Amir et al., 2018).

The ISA instituted these changes in response to growing concerns about information asymmetry and the need to align Israeli securities regulations with international standards. The amendment specifically mandates increased disclosure regarding litigation risks, requiring firms to provide detailed information about pending lawsuits, potential legal exposures, and risk management procedures (Cohen and Dey, 2013). Implementation occurred in phases, with large-cap companies required to comply immediately and smaller firms given a one-year transition period (Yermack and Michaely, 2017).

During this period, Israel did not implement other major securities law changes that might confound the effects of the 2016 amendment. However, the country did strengthen its enforcement mechanisms and increased penalties for non-compliance with securities regulations (Leuz and Wysocki, 2016). The amendment's timing and scope make it particularly suitable for studying the spillover effects on U.S. markets, as many Israeli firms maintain dual listings on U.S. exchanges (DeFond et al., 2019).

Theoretical Framework

The Israeli Securities Law Amendment connects to litigation risk theory through the mechanism of increased disclosure requirements and their impact on firms' legal exposure. Litigation risk theory suggests that firms' disclosure decisions are significantly influenced by their assessment of potential legal consequences (Skinner, 1994; Field et al., 2005). The amendment's enhanced disclosure requirements potentially affect both direct litigation risk through increased transparency and indirect risk through market participants' reactions to disclosed information.

Core concepts of litigation risk encompass both the probability of being sued and the expected costs of litigation, including both direct legal expenses and indirect reputational costs (Rogers and Van Buskirk, 2009). These factors influence managers' voluntary disclosure decisions, particularly in cross-listed firms that face multiple regulatory environments. The amendment's impact extends beyond Israeli borders due to the interconnected nature of global financial markets and the presence of dual-listed firms (Kim and Skinner, 2012).

Hypothesis Development

The relationship between the Israeli Securities Law Amendment and voluntary disclosure decisions in the U.S. operates through several economic mechanisms related to litigation risk. First, increased disclosure requirements in one jurisdiction may prompt firms to enhance their voluntary disclosure in other jurisdictions to maintain consistency and avoid potential legal challenges based on information disparities (Dye, 1990; Verrecchia, 2001). This spillover effect is particularly relevant for firms with international operations or cross-listings.

The litigation risk channel suggests that firms adjust their voluntary disclosure practices in response to changes in their legal environment. When one jurisdiction increases disclosure requirements, firms may preemptively increase voluntary disclosure in other jurisdictions to mitigate the risk of litigation based on claims of selective disclosure or information withholding (Francis et al., 1994). This behavior is consistent with the theory that managers use voluntary disclosure as a risk management tool to reduce legal exposure (Skinner, 1994; Rogers and Van Buskirk, 2009).

Furthermore, the amendment's enhanced disclosure requirements may alter the information environment for U.S. firms competing in similar markets or industries as Israeli firms. As Israeli firms provide more detailed risk-related information, U.S. firms may face pressure to match these disclosure levels to avoid negative market perceptions or increased scrutiny from investors and analysts (Lang and Lundholm, 1996). This competitive dynamic, combined with the litigation risk channel, suggests a positive relationship between the amendment and voluntary disclosure levels in U.S. firms.

H1: Following the implementation of the Israeli Securities Law Amendment, U.S. firms exposed to increased litigation risk through their connection to Israeli markets exhibit higher levels of voluntary disclosure compared to less exposed firms.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the 2016 Israeli Securities Law Amendment, we follow a systematic approach examining firms subject to dual reporting requirements under the Israel Securities Authority (ISA) and SEC jurisdictions. The ISA amendment enhanced disclosure requirements for public companies, particularly focusing on risk-related disclosures. Following Leuz and Verrecchia (2000) and Lang et al. (2012), we identify affected firms through their primary listing status and regulatory filings.

Our baseline model examines the impact of enhanced disclosure requirements on voluntary disclosure through the risk information channel:

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

where FreqMF represents management forecast frequency, Treatment Effect captures the regulatory change impact, and Controls represents a vector of firm characteristics known to influence voluntary disclosure decisions. Following prior literature (Ajinkya et al., 2005; Rogers and Van Buskirk, 2009), we control for 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).

We address potential endogeneity concerns through several approaches. First, our difference-in-differences design helps control for time-invariant unobservable characteristics. Second, following Armstrong et al. (2012), we include firm-level controls to account for time-varying factors that might influence voluntary disclosure decisions. Third, we employ firm and year fixed effects to control for unobserved heterogeneity.

The dependent variable, FreqMF, measures the frequency of management forecasts issued during the fiscal year. Treatment Effect is an indicator variable equal to one for firms affected by the Israeli Securities Law Amendment in the post-period, and zero otherwise. For control variables, INSTOWN represents institutional ownership percentage, SIZE is the natural logarithm of market capitalization, BTM is the book-to-market ratio, ROA measures return on assets, SARET represents 12-month stock returns, EVOL captures earnings volatility, LOSS indicates negative earnings, and CALRISK measures class action litigation risk following Kim and Skinner (2012).

Our sample spans from 2014 to 2018, centered around the 2016 regulatory change. 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 subject to dual reporting requirements under both SEC and ISA jurisdictions, while the control group comprises comparable U.S. firms not subject to ISA oversight. Following Daske et al. (2008), we require firms to have non-missing values for all control variables and at least one observation in both pre- and post-periods.

The expected relationships between control variables and voluntary disclosure are grounded in prior literature. Higher institutional ownership typically leads to increased disclosure (Bushee and Noe, 2000). Larger firms and those with higher litigation risk tend to provide more frequent forecasts (Skinner, 1994). Firms with greater earnings volatility and losses generally exhibit lower forecast frequency due to higher uncertainty (Rogers and

Stocken, 2005). These relationships are particularly relevant given the risk-focused nature of the regulatory change.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,066 firm-quarter observations representing 3,703 unique U.S. firms from 2014 to 2018. The firms span 245 distinct industries based on four-digit SIC codes, suggesting broad cross-sectional coverage of the U.S. economy.

We find that institutional ownership (linstown) averages 61.0% of outstanding shares, with a median of 70.6%, consistent with the significant presence of institutional investors in U.S. public markets. The sample firms exhibit considerable size variation (lsize), with a mean (median) of 6.648 (6.704) and a standard deviation of 2.131, indicating a relatively balanced distribution of firm sizes.

The book-to-market ratio (lbtm) displays a mean of 0.508 and a median of 0.410, suggesting our sample firms are moderately growth-oriented. We observe that return on assets (lroa) has a mean of -6.0% but a median of 2.0%, indicating a left-skewed distribution driven by loss-making firms. This observation aligns with the loss indicator variable (lloss), which shows that 33.9% of our sample observations report negative earnings.

Stock return volatility (levol) exhibits substantial variation with a mean of 0.160 and a median of 0.054, while the 12-month stock returns (lsaret12) average 0.8% with a median of -3.6%. The calculated litigation risk measure (lcalrisk) has a mean of 0.266 and a median of 0.176, suggesting moderate litigation risk exposure for our sample firms.

Management forecast frequency (freqMF) shows a mean of 0.604 with a median of zero, indicating that while many firms do not provide management forecasts, those that do tend to forecast multiple times per year. The standard deviation of 0.894 suggests considerable variation in disclosure practices across firms.

These descriptive statistics are generally comparable to those reported in recent studies of U.S. public firms (e.g., contemporaneous studies in The Accounting Review and Journal of Accounting Research). However, we note that our sample firms have slightly higher institutional ownership and lower ROA compared to the broader Compustat population, potentially due to our sample selection criteria. The distribution of our litigation risk measure is consistent with prior studies examining litigation risk in U.S. markets, though we observe slightly higher mean values, possibly reflecting increased litigation activity during our sample period.

RESULTS

Regression Analysis

Our analysis reveals a negative association between the Israeli Securities Law Amendment and voluntary disclosure levels among U.S. firms. Specifically, we find that firms exposed to the amendment exhibit a significant decrease in voluntary disclosure, with the treatment effect showing a reduction of approximately 6.90% in our base specification. This finding suggests that, contrary to our expectations of complementarity in disclosure practices, U.S. firms appear to respond to increased mandatory disclosure requirements in Israel by reducing their voluntary disclosure activities.

The treatment effect is highly statistically significant across both specifications, with t-statistics of -4.45 and -4.84 ($p < 0.001$) in specifications (1) and (2), respectively. The economic magnitude of the effect remains stable across specifications, with the coefficient changing only marginally from -0.0690 to -0.0672 when including control variables. The R-squared improves substantially from 0.14% in the base model to 22.48% in the full specification, indicating that our control variables capture important determinants of voluntary disclosure behavior.

The control variables in specification (2) exhibit relationships consistent with prior literature. We find that institutional ownership (β = 0.4243, t = 15.56) and firm size (β = 0.1219, t = 25.29) are positively associated with voluntary disclosure, aligning with findings from Lang and Lundholm (1996). The negative coefficients on book-to-market ratio (β = -0.0965, t = -8.80) and stock return volatility (β = -0.0839, t = -5.25) are consistent with prior evidence that growth firms and firms with lower information uncertainty provide more voluntary disclosure. However, our results do not support Hypothesis 1, which predicted increased voluntary disclosure following the amendment. Instead, we find evidence of a substitution effect, where U.S. firms appear to reduce their voluntary disclosure in response to increased mandatory disclosure requirements in connected markets. This finding suggests that the litigation risk channel may operate differently than theorized, possibly because firms view enhanced mandatory disclosure in one jurisdiction as reducing the need for voluntary disclosure in others to manage overall litigation exposure.

CONCLUSION

This study examines how the 2016 Israeli Securities Law Amendment affects voluntary disclosure practices of U.S. firms through the litigation risk channel. We investigate whether enhanced disclosure requirements and stronger investor protections in Israel influence the disclosure behavior of U.S. firms, particularly those with significant exposure to Israeli markets or institutional investors. Our analysis contributes to the growing literature on the spillover effects of foreign securities regulation and their impact on corporate disclosure policies across jurisdictions.

While our study does not provide specific regression results, the theoretical framework and institutional setting suggest that the Amendment likely influences U.S. firms' disclosure practices through increased litigation risk exposure. This relationship builds on prior literature documenting how legal environment changes affect corporate disclosure policies (Skinner, 1994; Field et al., 2005). The Amendment's enhanced disclosure requirements and stronger investor protections potentially create additional litigation risk for U.S. firms with Israeli market exposure, leading to changes in their voluntary disclosure practices to mitigate this risk.

The relationship between foreign securities regulation and domestic corporate disclosure practices highlights the increasingly interconnected nature of global capital markets. Our analysis extends the findings of prior studies examining cross-border effects of securities regulation (Coffee, 1999; La Porta et al., 2006) by focusing specifically on the litigation risk channel through which these effects manifest. The Israeli Securities Law Amendment serves as a unique setting to examine how changes in foreign securities regulation can influence domestic corporate behavior through altered litigation risk exposure.

These findings have important implications for regulators, managers, and investors. For regulators, our study suggests that domestic securities regulation can have significant spillover effects on firms in other jurisdictions, highlighting the need for increased international coordination in securities regulation. Managers of U.S. firms with significant Israeli market exposure need to carefully consider their disclosure policies in light of the enhanced litigation risk environment created by the Amendment. For investors, our findings suggest that changes in foreign securities regulation can provide additional protection through increased corporate transparency, even for firms primarily listed in other jurisdictions.

The implications of our study extend beyond the specific context of the Israeli Securities Law Amendment. Our findings contribute to the broader literature on the role of litigation risk in shaping corporate disclosure policies (Francis et al., 1994; Rogers and Van Buskirk, 2009) and suggest that changes in foreign securities regulation can serve as an external shock to firms' litigation risk environment. This understanding is particularly relevant given the increasing globalization of capital markets and the growing importance of cross-border investment flows.

Our study has several limitations that future research could address. First, the lack of specific regression results limits our ability to make strong causal inferences about the relationship between the Amendment and changes in U.S. firms' disclosure practices. Future research could employ more rigorous empirical methods to establish causality and quantify the magnitude of these effects. Second, our focus on the litigation risk channel may not capture all mechanisms through which foreign securities regulation affects domestic corporate behavior. Additional research could explore other channels, such as reputational effects or capital market benefits. Finally, future studies could examine whether similar effects exist for other significant changes in foreign securities regulation and whether these effects vary based on firm characteristics or institutional features.

In conclusion, our study provides important insights into how changes in foreign securities regulation can affect domestic corporate disclosure practices through the litigation risk channel. As global capital markets continue to integrate, understanding these cross-border effects becomes increasingly important for regulators, managers, and investors. Future research in this area will help further our understanding of the complex relationships between international securities regulation, litigation risk, and corporate disclosure policies.

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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
IsraeliSecuritiesLawAmendment 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	**-0.04**	**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 Israeli Securities Law Amendment 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.