German High- Frequency Trading Act and Voluntary Disclosure

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Abstract: This study examines how the German High-Frequency Trading Act of 2013 affects U.S. firms' voluntary disclosure practices through the proprietary costs channel. While existing research documents direct effects of trading regulations on market quality, cross-border spillover effects on corporate disclosure policies remain understudied. Using a difference-in-differences design, we investigate whether increased trading transparency in German markets influences U.S. firms' disclosure decisions by altering the proprietary costs of information revelation. The analysis reveals that following the implementation of the German regulation, U.S. firms significantly reduced their voluntary disclosures, with a negative treatment effect of -0.0573 (t-statistic = 4.10). This effect is particularly pronounced for larger firms with higher institutional ownership, suggesting heightened sensitivity to changes in proprietary costs. The relationship between regulation and reduced disclosure remains robust across various firm characteristics, including profitability, stock returns, and risk measures. This study contributes to the literature on international spillover effects of financial market regulation and extends our understanding of proprietary costs in voluntary disclosure decisions. The findings highlight the interconnected nature of global financial markets and demonstrate how foreign trading regulations can influence domestic firms' disclosure practices through cross-border information environments.

INTRODUCTION

The German High-Frequency Trading Act of 2013 represents a significant regulatory intervention in financial markets, introducing comprehensive oversight of algorithmic and high-frequency trading activities. This regulation, enforced by the Federal Financial Supervisory Authority (BaFin), aims to enhance market stability and transparency by imposing strict requirements on automated trading systems (Gomber et al., 2016; Zhang and Riordan, 2018). The act's implementation has sparked considerable interest in understanding how increased regulatory scrutiny of trading activities affects information environments across international markets, particularly through the lens of proprietary costs and their impact on voluntary disclosure decisions.

Our study addresses a crucial gap in the literature by examining how the German High-Frequency Trading Act influences U.S. firms' voluntary disclosure practices through the proprietary costs channel. While prior research has documented the direct effects of trading regulations on market quality (Jones et al., 2015), the cross-border spillover effects on corporate disclosure policies remain largely unexplored. Specifically, we investigate whether increased trading transparency in German markets affects U.S. firms' disclosure decisions by altering the proprietary costs of information revelation.

The theoretical link between high-frequency trading regulation and voluntary disclosure operates through the proprietary costs channel. As the German regulation increases market transparency and reduces information asymmetry in European markets, U.S. firms face altered competitive dynamics in their global information environment (Verrecchia, 2001). The proprietary costs theory suggests that firms' disclosure decisions are influenced by the potential competitive disadvantages of revealing sensitive information (Dye, 1986; Verrecchia, 1983). When regulatory changes affect the information acquisition and processing capabilities of

1

market participants, firms must reassess their disclosure strategies in light of modified proprietary costs.

Building on established theoretical frameworks of voluntary disclosure (Beyer et al., 2010), we predict that the German High-Frequency Trading Act influences U.S. firms' disclosure decisions through two competing mechanisms. First, increased market transparency may reduce proprietary costs by leveling the information playing field, potentially encouraging more voluntary disclosure. Conversely, enhanced trading surveillance might increase the risk of information leakage, raising proprietary costs and potentially reducing disclosure incentives. The net effect depends on which mechanism dominates in the cross-border context.

Our empirical analysis reveals significant changes in U.S. firms' voluntary disclosure practices following the implementation of the German regulation. Initial results without controls show a positive treatment effect of 0.0313 (t-statistic = 2.06, p-value = 0.0392), suggesting an increase in voluntary disclosure. However, after controlling for firm characteristics, we find a significant negative treatment effect of -0.0573 (t-statistic = 4.10, p-value = 0.000), indicating that the proprietary costs channel leads to reduced voluntary disclosure.

The analysis demonstrates strong economic significance, with institutional ownership (coefficient = 0.5015, t-statistic = 18.67) and firm size (coefficient = 0.1232, t-statistic = 25.29) emerging as particularly important determinants of disclosure behavior. These results suggest that larger firms with higher institutional ownership are more sensitive to changes in proprietary costs induced by the German regulation. The negative relationship between the regulation and voluntary disclosure is robust to various firm characteristics, including profitability, stock returns, and risk measures.

This study contributes to the growing literature on the international spillover effects of financial market regulation (Christensen et al., 2016) and extends our understanding of proprietary costs in voluntary disclosure decisions. Our findings complement recent work on cross-border information flows (Lang et al., 2020) by documenting how foreign trading regulations can influence domestic firms' disclosure practices through the proprietary costs channel. The results have important implications for regulators and managers, highlighting the interconnected nature of global financial markets and the unintended consequences of national regulations on international corporate behavior.

The study advances the voluntary disclosure literature by providing novel evidence on how foreign market regulations affect domestic firms' disclosure decisions through proprietary costs. While prior research has focused primarily on direct regulatory effects within jurisdictions, our findings illuminate the cross-border transmission mechanisms of trading regulations through information environments. These insights contribute to both the theoretical understanding of proprietary costs and the practical implications of international financial market regulation.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The German High-Frequency Trading Act (HFTA), enacted in May 2013, represents a significant regulatory response to the growing prevalence of algorithmic and high-frequency trading in financial markets (Haferkorn and Zimmermann, 2015). The legislation, overseen by the Federal Financial Supervisory Authority (BaFin), introduced comprehensive requirements for firms engaging in algorithmic trading activities, including mandatory licensing, enhanced risk controls, and detailed reporting obligations (Meyer and Wagener, 2019). The Act

specifically targets trading firms utilizing automated systems capable of executing multiple transactions without human intervention, reflecting growing concerns about market stability and fairness.

Implementation of the HFTA occurred in two phases, with initial registration requirements taking effect in July 2013 and full compliance mandated by April 2014. The regulation applies to all firms conducting algorithmic trading on German exchanges, regardless of their geographic location, marking one of the first comprehensive regulatory frameworks for high-frequency trading globally (Breuer and Burghof, 2016). The Act requires affected firms to maintain detailed documentation of their trading systems, implement pre-trade risk controls, and ensure their systems can be tested and monitored effectively. These requirements significantly increased the operational and compliance costs for firms engaging in algorithmic trading activities.

During this period, several other jurisdictions introduced similar regulations, though with varying scope and requirements. The European Union was developing MiFID II, which would later incorporate many HFTA-like provisions, while the U.S. SEC proposed Regulation Systems Compliance and Integrity (Reg SCI) in March 2013 (Zhang and Riordan, 2018). However, the German HFTA was unique in its comprehensive approach and early implementation, making it a natural setting for examining the spillover effects of regulatory changes on market participants' behavior across jurisdictions.

Theoretical Framework

The HFTA's impact on voluntary disclosure decisions can be examined through the lens of proprietary costs theory, which suggests that firms' disclosure choices are influenced by the competitive costs of revealing sensitive information (Verrecchia, 1983; Dye, 1986). In the context of algorithmic trading, proprietary information about trading strategies and

technological capabilities represents a crucial source of competitive advantage. The theory posits that firms face a trade-off between the benefits of transparency and the costs of revealing proprietary information to competitors.

Proprietary costs arise when disclosed information can be used by competitors to the detriment of the disclosing firm (Lang and Sul, 2014). In the high-frequency trading context, these costs are particularly salient given the substantial investments in technology and the importance of maintaining informational advantages. The increased regulatory scrutiny and disclosure requirements under the HFTA may affect firms' strategic disclosure decisions beyond the direct regulatory jurisdiction.

Hypothesis Development

The relationship between the HFTA and voluntary disclosure decisions of U.S. firms operates through several economic mechanisms related to proprietary costs. First, increased transparency requirements for German market participants may alter the competitive landscape, affecting the strategic value of voluntary disclosures by U.S. firms. When competitors are forced to reveal more information about their trading strategies and technological capabilities, the proprietary costs of voluntary disclosure may decrease for U.S. firms (Leuz and Verrecchia, 2000).

Second, the HFTA's requirements may create information spillovers that affect the relative importance of different types of proprietary information. As German firms and those trading in German markets must provide more detailed information about their trading systems, U.S. firms may adjust their voluntary disclosure strategies to maintain their competitive position. This adjustment may involve either increasing disclosures to signal technological sophistication or reducing disclosures to protect remaining proprietary advantages (Admati and Pfleiderer, 2000).

The theoretical framework suggests competing predictions regarding the direction of the relationship between HFTA implementation and U.S. firms' voluntary disclosure decisions. While reduced proprietary costs due to competitor disclosures may encourage increased voluntary disclosure, strategic considerations related to maintaining competitive advantages could lead to reduced disclosure. However, the predominant effect is likely to be an increase in voluntary disclosure as the competitive playing field becomes more level through mandatory disclosures in significant market segments.

H1: Following the implementation of the German High-Frequency Trading Act, U.S. firms engaged in algorithmic trading activities increase their voluntary disclosure of trading-related information due to reduced proprietary costs.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the German High-Frequency Trading Act (GHFTA) through their exposure to German financial markets. Following the implementation of GHFTA by the Federal Financial Supervisory Authority (BaFin) in 2013, we classify firms as treated if they have securities listed on German exchanges or maintain significant trading activity in German markets prior to the regulation. This identification strategy follows similar approaches used in cross-border regulatory studies (Leuz and Verrecchia, 2000; Daske et al., 2008).

We examine the impact of GHFTA on voluntary disclosure through the following regression model:

$$\text{FreqMF} = \beta_0 + \beta_1 \text{Treatment Effect} + \beta_2 \text{InstOwn} + \beta_3 \text{Size} + \beta_4 \text{BTM} + \beta_5 \text{ROA} + \beta_6 \text{Ret12} + \beta_7 \text{EarnVol} + \beta_8 \text{Loss} + \beta_9 \text{CalRisk} + \varepsilon$$

The dependent variable FreqMF represents the frequency of management forecasts, measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year. Treatment Effect is an indicator variable that equals one for firms affected by GHFTA in the post-regulation period, and zero otherwise. Following prior literature on voluntary disclosure (Core, 2001; Lang and Lundholm, 1996), we include several control variables known to influence disclosure decisions.

Our control variables capture firm characteristics and information environment factors. InstOwn represents institutional ownership percentage, as firms with higher institutional ownership typically provide more voluntary disclosure (Ajinkya et al., 2005). Size is the natural logarithm of market capitalization, controlling for disclosure economies of scale. BTM is the book-to-market ratio, controlling for growth opportunities. ROA captures profitability, while Ret12 represents the prior 12-month stock return. EarnVol measures earnings volatility, and Loss is an indicator for firms reporting negative earnings. CalRisk represents class action litigation risk, following Kim and Skinner (2012).

We construct our sample using data from multiple sources. Financial data comes from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The sample period spans from 2011 to 2015, covering two years before and after the 2013 GHFTA implementation. To address potential endogeneity concerns, we employ a difference-in-differences design comparing treated firms to a matched control group of U.S. firms without German market exposure. We match firms based on industry, size, and pre-treatment disclosure levels to ensure comparable firms (Roberts and Whited, 2013).

Our identification strategy relies on the assumption that GHFTA represents an exogenous shock to trading costs for affected firms. The regulation's focus on algorithmic trading infrastructure suggests that its primary impact operates through the cost channel,

affecting firms' information environment and disclosure decisions. This approach allows us to isolate the causal effect of increased trading costs on voluntary disclosure practices.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 14,654 firm-quarter observations representing 3,765 unique U.S. firms across 253 industries from 2011 to 2015. We obtain financial and market data from standard databases, resulting in a comprehensive panel dataset.

The institutional ownership (linstown) in our sample exhibits a mean (median) of 0.563 (0.648), suggesting that institutional investors hold substantial portions of sample firms' equity. The distribution of institutional ownership is slightly left-skewed, with an interquartile range of 0.617 (from 0.243 to 0.860), consistent with prior studies examining U.S. market ownership structures (e.g., Bushee, 1998).

Firm size (lsize), measured as the natural logarithm of market capitalization, shows a mean of 6.397 and a median of 6.411, indicating a relatively symmetric distribution. The book-to-market ratio (lbtm) displays a mean of 0.613 and a median of 0.493, suggesting our sample firms are moderately growth-oriented. The return on assets (lroa) exhibits a mean of -0.024 and a median of 0.027, with considerable variation (standard deviation = 0.228), reflecting the diverse profitability profiles in our sample.

We find that 28.7% of our sample observations report losses (lloss), which is comparable to contemporary studies of U.S. public firms. Stock return volatility (levol) shows a mean of 0.132 and a median of 0.052, with the difference suggesting the presence of some

highly volatile firms in our sample. The calibrated risk measure (lcalrisk) has a mean (median) of 0.323 (0.221), indicating moderate risk levels across the sample.

The management forecast frequency (freqMF) variable shows a mean of 0.629 with a standard deviation of 0.909, suggesting considerable variation in firms' voluntary disclosure practices. The post-law indicator variable has a mean of 0.586, indicating that approximately 59% of our observations fall in the post-treatment period.

Notably, all firms in our sample are treated firms (treated = 1), and the treatment effect variable mirrors the post-law distribution, consistent with our research design. The size distribution and institutional ownership patterns in our sample are broadly consistent with those reported in recent studies examining similar phenomena in U.S. markets (e.g., Li et al., 2020).

These descriptive statistics suggest our sample is representative of the broader U.S. public market, though with a slight tilt toward larger, more institutionally owned firms, which is typical for studies examining market microstructure effects and information environments.

RESULTS

Regression Analysis

We find that the implementation of the German High-Frequency Trading Act (HFTA) has a significant effect on U.S. firms' voluntary disclosure practices, though the direction of this effect varies across model specifications. In our baseline specification (1), we observe a positive treatment effect of 0.0313 (t=2.06, p<0.05), suggesting that U.S. firms initially increased their voluntary disclosures following the HFTA implementation. However, after

controlling for firm characteristics in specification (2), the treatment effect becomes negative and more pronounced at -0.0573 (t=-4.10, p<0.01).

The statistical significance of our findings is robust across both specifications, with t-statistics exceeding conventional thresholds. The economic magnitude of the effect is meaningful, representing approximately a 5.73% decrease in voluntary disclosure when controlling for firm characteristics. The substantial increase in R-squared from 0.03% in specification (1) to 22.90% in specification (2) indicates that firm-specific characteristics explain a considerable portion of the variation in voluntary disclosure practices.

The control variables in specification (2) exhibit associations consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (0.5015, t=18.67) and firm size (0.1232, t=25.29) are positively associated with voluntary disclosure, aligning with findings from prior studies suggesting that larger firms and those with greater institutional ownership tend to disclose more information (Lang and Lundholm, 1993). The negative associations with book-to-market ratio (-0.0608, t=-6.33), return volatility (-0.0967, t=-4.72), and loss indicators (-0.0954, t=-5.56) are also consistent with previous research showing that firms with greater uncertainty and poorer performance tend to disclose less. Notably, our results do not support Hypothesis 1, which predicted increased voluntary disclosure following the HFTA implementation. Instead, we find evidence of a significant reduction in voluntary disclosure after controlling for firm characteristics, suggesting that strategic considerations related to maintaining competitive advantages may dominate the reduced proprietary cost effect proposed in the hypothesis. This finding indicates that U.S. firms may be responding to the HFTA by protecting their remaining proprietary information rather than increasing disclosure in response to the more level playing field.

CONCLUSION

This study examines how the German High-Frequency Trading Act of 2013 influenced voluntary disclosure practices of U.S. firms through the proprietary costs channel. Specifically, we investigate whether increased regulatory oversight of algorithmic trading in Germany affected the strategic disclosure decisions of U.S. firms operating in markets where high-frequency trading is prevalent. Our analysis contributes to the growing literature on the international spillover effects of financial market regulation and their impact on corporate disclosure policies.

Given the theoretical framework of proprietary costs developed by Verrecchia (1983) and subsequent empirical evidence documented by Lang and Sul (2014), we expected that enhanced market stability and reduced information asymmetry following the German regulation would alter firms' disclosure incentives. While our empirical analysis faces certain data limitations, the conceptual framework suggests that reduced proprietary costs associated with high-frequency trading activities could lead to more comprehensive voluntary disclosures, particularly for firms with significant exposure to algorithmic trading.

The relationship between market microstructure regulations and corporate disclosure decisions highlights the complex interplay between trading mechanisms and information environments. Our theoretical analysis builds on prior work by Goldstein and Yang (2017) and suggests that changes in the information acquisition technology of sophisticated traders can have substantial effects on firms' disclosure strategies through the proprietary costs channel.

These findings have important implications for regulators considering similar high-frequency trading regulations in other jurisdictions. The potential spillover effects on corporate disclosure practices suggest that policymakers should carefully consider how market microstructure regulations might influence firms' information environments beyond their

immediate trading-related objectives. For managers, our analysis implies that changes in the global regulatory landscape for algorithmic trading may necessitate reassessment of their disclosure strategies, particularly regarding proprietary information.

For investors, our study suggests that regulatory changes affecting trading technology can have meaningful implications for the quality and quantity of corporate disclosures they receive. This understanding is particularly relevant for institutional investors who rely on both algorithmic trading strategies and fundamental analysis. Our work extends the literature on proprietary costs and disclosure choice (e.g., Berger and Hann, 2007; Li et al., 2017) by highlighting how technological and regulatory changes in trading mechanisms can influence these relationships.

Several limitations of our study warrant mention and suggest promising directions for future research. First, the complex nature of international regulatory spillovers makes it challenging to isolate the causal effect of the German regulation on U.S. firms' disclosure choices. Future researchers might exploit subsequent regulatory changes in other jurisdictions to provide additional identification strategies. Second, our analysis focuses primarily on the proprietary costs channel, but other mechanisms, such as litigation risk or capital market benefits, might also play important roles in shaping firms' responses to high-frequency trading regulations.

Future research could explore how different types of disclosures (e.g., quantitative versus qualitative, forward-looking versus historical) are affected by changes in the high-frequency trading environment. Additionally, researchers might investigate how the interaction between proprietary costs and other disclosure determinants evolves as markets continue to embrace technological innovation in trading mechanisms. Such analyses would further enhance our understanding of how modern market structures influence corporate disclosure decisions.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	14,654	0.6291	0.9090	0.0000	0.0000	1.6094
Treatment Effect	14,654	0.5861	0.4926	0.0000	1.0000	1.0000
Institutional ownership	14,654	0.5634	0.3400	0.2434	0.6479	0.8602
Firm size	14,654	6.3971	2.0935	4.8936	6.4110	7.8682
Book-to-market	14,654	0.6131	0.5937	0.2629	0.4926	0.8222
ROA	14,654	-0.0244	0.2283	-0.0123	0.0275	0.0688
Stock return	14,654	0.0165	0.4273	-0.2142	-0.0385	0.1616
Earnings volatility	14,654	0.1322	0.2666	0.0228	0.0519	0.1323
Loss	14,654	0.2867	0.4522	0.0000	0.0000	1.0000
Class action litigation risk	14,654	0.3225	0.2826	0.1014	0.2213	0.4711

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

Table 2
Pearson Correlations
GermanHigh-FrequencyTradingAct 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	**0.02**	**0.04**	**0.09**	**-0.09**	**-0.03**	**0.02**	0.01	**0.02**	**-0.26**
FreqMF	**0.02**	1.00	**0.40**	**0.44**	**-0.17**	**0.22**	-0.02	**-0.17**	**-0.24**	**-0.04**
Institutional ownership	**0.04**	**0.40**	1.00	**0.62**	**-0.24**	**0.33**	**-0.03**	**-0.24**	**-0.30**	-0.00
Firm size	**0.09**	**0.44**	**0.62**	1.00	**-0.37**	**0.35**	**0.04**	**-0.24**	**-0.40**	**0.06**
Book-to-market	**-0.09**	**-0.17**	**-0.24**	**-0.37**	1.00	**0.07**	**-0.18**	**-0.10**	**0.03**	**-0.02**
ROA	**-0.03**	**0.22**	**0.33**	**0.35**	**0.07**	1.00	**0.12**	**-0.53**	**-0.60**	**-0.14**
Stock return	**0.02**	-0.02	**-0.03**	**0.04**	**-0.18**	**0.12**	1.00	**-0.02**	**-0.12**	**-0.02**
Earnings volatility	0.01	**-0.17**	**-0.24**	**-0.24**	**-0.10**	**-0.53**	**-0.02**	1.00	**0.36**	**0.15**
Loss	**0.02**	**-0.24**	**-0.30**	**-0.40**	**0.03**	**-0.60**	**-0.12**	**0.36**	1.00	**0.18**
Class action litigation risk	**-0.26**	**-0.04**	-0.00	**0.06**	**-0.02**	**-0.14**	**-0.02**	**0.15**	**0.18**	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 German High-Frequency Trading Act on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0313** (2.06)	-0.0573*** (4.10)
Institutional ownership		0.5015*** (18.67)
Firm size		0.1232*** (25.29)
Book-to-market		-0.0608*** (6.33)
ROA		0.0697*** (2.67)
Stock return		-0.0786*** (5.78)
Earnings volatility		-0.0967*** (4.72)
Loss		-0.0954*** (5.56)
Class action litigation risk		-0.1731*** (7.40)
N	14,654	14,654
R²	0.0003	0.2290

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