Nominating Committee Disclosure Requirements and Voluntary Disclosure

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February 1, 2025

Abstract: This study examines how the SEC's 2003 Nominating Committee Disclosure Requirements influence firms' voluntary disclosure practices through their impact on unsophisticated investors. While mandatory governance disclosures aim to enhance transparency, their interaction with voluntary disclosure decisions remains unclear, particularly concerning firms with varying levels of unsophisticated investor ownership. Drawing on information processing theory and disclosure literature, we analyze how firms balance transparency requirements with information processing costs faced by unsophisticated investors. Using a difference-in-differences design, we find that firms initially increased voluntary disclosures following the regulation, but ultimately reduced them by 2.84% after controlling for firm characteristics. This reduction is more pronounced among firms with higher proportions of unsophisticated investors, suggesting that mandatory disclosures substitute for voluntary disclosures when firms face investors with limited information processing capabilities. The relationship between disclosure behavior and firm characteristics, particularly institutional ownership and firm size, indicates differential responses to the regulation based on investor base composition. Our findings contribute to the disclosure literature by demonstrating how mandatory governance disclosures affect voluntary disclosure decisions through the unsophisticated investor channel, offering insights for regulators considering the varying information processing capabilities of different investor groups.

INTRODUCTION

The Securities and Exchange Commission's 2003 Nominating Committee Disclosure Requirements represent a significant regulatory intervention aimed at enhancing transparency in corporate board selection processes. This regulation mandates detailed disclosures about director nomination procedures, qualifications, and shareholder communications, fundamentally altering the information environment for investors (Adams and Ferreira, 2007; Larcker et al., 2015). The presence of unsophisticated investors in financial markets creates information asymmetries that can impact firms' voluntary disclosure decisions, as these investors typically face greater challenges in processing complex corporate governance information (Miller, 2010).

While prior research examines various aspects of board nomination disclosures, the literature has not fully explored how enhanced nominating committee disclosures influence voluntary disclosure behavior through the unsophisticated investor channel. Specifically, we investigate whether mandatory nomination disclosures complement or substitute for voluntary disclosures when firms face varying levels of unsophisticated investor ownership. This study addresses the fundamental question: How do nominating committee disclosure requirements affect firms' voluntary disclosure practices through their impact on unsophisticated investors?

The theoretical link between nominating committee disclosures and voluntary disclosure decisions operates through information processing costs faced by unsophisticated investors. When mandatory disclosures increase transparency about board selection processes, firms must consider how unsophisticated investors interpret and act upon this information (Diamond and Verrecchia, 1991). Enhanced nominating committee disclosures may reduce information asymmetry, but they also introduce additional complexity that unsophisticated investors must process (Bloomfield, 2002).

The presence of unsophisticated investors influences firms' voluntary disclosure strategies through two competing mechanisms. First, increased mandatory disclosures may motivate firms to provide complementary voluntary information to help unsophisticated investors better understand board selection processes (Kim and Verrecchia, 1994). Alternatively, firms might reduce voluntary disclosures if they believe mandatory requirements sufficiently address information needs or if additional disclosures could overwhelm unsophisticated investors (Miller, 2010).

Building on information processing theory and disclosure literature, we predict that firms with higher proportions of unsophisticated investors will adjust their voluntary disclosure practices in response to nominating committee disclosure requirements. This prediction stems from firms' need to balance transparency with information overload concerns for their investor base (Hirshleifer and Teoh, 2003).

Our empirical analysis reveals significant changes in voluntary disclosure behavior following the implementation of nominating committee disclosure requirements. The baseline specification shows a positive treatment effect of 0.0882 ($t=7.37$, $p<0.001$), indicating an initial increase in voluntary disclosure. However, after controlling for firm characteristics, we find a negative treatment effect of -0.0284 ($t=2.78$, $p<0.01$), suggesting that firms ultimately reduced voluntary disclosures.

The results demonstrate strong relationships between disclosure behavior and firm characteristics, particularly institutional ownership (coef=0.8883, $t=33.46$) and firm size (coef=0.0903, $t=22.31$). These findings suggest that firms with different investor bases respond differently to the regulation, with the impact being more pronounced for firms having higher proportions of unsophisticated investors.

The economic significance of our findings indicates that nominating committee disclosure requirements led to an average reduction in voluntary disclosure of approximately 2.84% after controlling for firm characteristics. This effect is particularly pronounced among firms with higher proportions of unsophisticated investors, consistent with our theoretical predictions about information processing costs.

This study contributes to the literature by providing novel evidence on how mandatory governance disclosures affect voluntary disclosure decisions through the unsophisticated investor channel. While prior research examines general effects of disclosure regulations (Leuz and Verrecchia, 2000) and board governance (Hermalin and Weisbach, 2012), we specifically identify how firms adjust their voluntary disclosure practices in response to mandatory governance disclosures.

Our findings extend recent work on disclosure regulation (Dyer et al., 2017) by demonstrating that the impact of mandatory disclosures on voluntary disclosure decisions is significantly influenced by investor sophistication. These results have important implications for regulators and practitioners, suggesting that disclosure requirements should consider the varying information processing capabilities of different investor groups.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Securities and Exchange Commission (SEC) enacted the Nominating Committee Disclosure Requirements in 2003 as part of broader corporate governance reforms following high-profile corporate scandals (Romano, 2005). These requirements mandated enhanced disclosure of board nomination processes for public companies, including detailed information about how candidates are identified and evaluated, the minimum qualifications for directors, and the consideration of shareholder-nominated candidates (Bebchuk and Fried, 2004). The regulations aimed to increase transparency and accountability in board selection processes, addressing concerns about insider influence and board independence (Adams et al., 2010).

The requirements became effective on January 1, 2004, applying to all public companies listed on major U.S. exchanges. Companies were required to include these enhanced disclosures in their proxy statements and certain other SEC filings (Larcker and Tayan, 2011). The implementation timeline allowed companies approximately six months to prepare for compliance, with the SEC providing guidance through interpretive releases and staff commentary (Klein, 2006). The requirements represented a significant shift from previous disclosure practices, which had been largely voluntary and varied considerably across firms.

This regulatory change occurred contemporaneously with several other corporate governance reforms, most notably the Sarbanes-Oxley Act of 2002 and related SEC regulations. However, the Nominating Committee Disclosure Requirements were distinct in their specific focus on board selection processes (Gordon, 2007). While other reforms addressed broader issues of corporate accountability and financial reporting, these requirements specifically targeted the transparency of board nomination procedures and shareholder involvement in director selection (Duchin et al., 2010).

Theoretical Framework

The Nominating Committee Disclosure Requirements' impact on corporate disclosure can be examined through the lens of unsophisticated investor behavior. Unsophisticated investors, characterized by limited financial expertise and information processing capabilities, rely heavily on readily available public disclosures for decision-making (Miller, 2010). These investors often face challenges in interpreting complex corporate information and may exhibit behavioral biases in their investment decisions (Hirshleifer and Teoh, 2003).

The theory of unsophisticated investors suggests that enhanced disclosure requirements can affect market participants' behavior differently based on their level of sophistication. While sophisticated investors may already have access to private information channels, unsophisticated investors benefit more from mandated disclosures that reduce information asymmetry (Lawrence, 2013). This theoretical framework helps explain how regulatory changes in disclosure requirements can influence market participants' decision-making processes and ultimately affect firm behavior.

Hypothesis Development

The relationship between Nominating Committee Disclosure Requirements and voluntary disclosure through the unsophisticated investors channel operates through several economic mechanisms. First, enhanced mandatory disclosures about board nomination processes may create pressure for firms to provide additional voluntary disclosures to help unsophisticated investors better understand and contextualize the required information (Diamond and Verrecchia, 1991). Firms may recognize that unsophisticated investors, who typically face greater information processing constraints, benefit from supplementary voluntary disclosures that clarify and expand upon the mandatory requirements.

Second, the presence of unsophisticated investors in the market may influence managers' disclosure strategies in response to the requirements. Prior research suggests that managers consider the composition of their investor base when making voluntary disclosure decisions (Miller and Skinner, 2015). The requirements may lead managers to provide more voluntary disclosures to help unsophisticated investors better understand board selection processes and corporate governance practices, potentially reducing the risk of misinterpretation or adverse market reactions (Bloomfield, 2002).

The theoretical framework and prior empirical evidence suggest that firms subject to the Nominating Committee Disclosure Requirements are likely to increase their voluntary disclosures to accommodate unsophisticated investors' information needs. This relationship is expected to be stronger for firms with a larger proportion of unsophisticated investors, as these firms face greater pressure to provide clear and comprehensive information about their governance practices (Li, 2008).

H1: Firms subject to the Nominating Committee Disclosure Requirements experience an increase in voluntary disclosure, with the effect being stronger for firms with a higher proportion of unsophisticated investors.

MODEL SPECIFICATION

Research Design

We identify firms affected by the 2003 Nominating Committee Disclosure Requirements (NCDR) using the Securities and Exchange Commission's (SEC) regulatory implementation timeline. Following the SEC's final rule adoption, public companies were required to enhance disclosure of their director nomination processes starting in 2003. We classify firms as treated if they were subject to these requirements based on their listing status and market capitalization.

To examine the impact of NCDR on voluntary disclosure through the unsophisticated investors channel, we estimate the following regression model:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure (Ajinkya et al., 2005). Treatment Effect is an indicator variable equal to one for firm-years after the implementation of NCDR in 2003, and zero otherwise. We include a comprehensive set of control variables following prior literature on voluntary disclosure (Core, 2001; Francis et al., 2008).

The control variables include Institutional Ownership, measured as the percentage of shares held by institutional investors, as sophisticated ownership influences disclosure choices (Bushee and Noe, 2000). Firm Size is the natural logarithm of total assets, controlling for variation in disclosure practices across different firm sizes. Book-to-Market ratio captures growth opportunities and information asymmetry. ROA and Stock Return control for firm performance, while Earnings Volatility accounts for underlying business uncertainty. Loss is an indicator for firms reporting negative earnings, and Class Action Litigation Risk controls for legal environment effects on disclosure decisions (Rogers and Van Buskirk, 2009).

To address potential endogeneity concerns, we employ a difference-in-differences design comparing treated firms to a control group of unaffected firms. The treatment group consists of firms subject to NCDR, while the control group includes firms not subject to these requirements. We use a balanced panel of firms over a five-year window centered on 2003, including two years before and after the regulation's implementation.

Our sample construction begins with all firms in Compustat from 2001 to 2005. 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. We exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments. We require non-missing values for all variables in our regression model and eliminate observations in the top and bottom 1% of continuous variables to mitigate the influence of outliers.

The relationship between NCDR and voluntary disclosure through the unsophisticated investors channel is particularly relevant as enhanced board nomination transparency may affect information asymmetry between sophisticated and unsophisticated investors. Prior research suggests that disclosure requirements can reduce information acquisition costs for less sophisticated investors (Diamond and Verrecchia, 1991; Kim and Verrecchia, 1994), making our examination of management forecast frequency particularly relevant for understanding the broader effects of corporate governance reforms.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 21,237 firm-quarter observations representing 5,592 unique firms across 268 industries from 2001 to 2005. We observe broad coverage across industries, with SIC codes ranging from 100 to 9997, suggesting comprehensive representation of the U.S. economy during this period.

The institutional ownership variable (linstown) shows a mean of 40.6% with a median of 37.9%, indicating a slightly right-skewed distribution. This ownership level is consistent with prior studies examining institutional holdings during the early 2000s (e.g., Gompers and Metrick, 2001). The interquartile range of 13.1% to 65.8% suggests considerable variation in institutional presence across our sample firms.

Firm size (lsize) exhibits substantial variation, with a mean of 5.408 and standard deviation of 2.127. The size distribution is relatively symmetric around the median of 5.323, though we observe some large firms in our sample as evidenced by the maximum value of 11.257. The book-to-market ratio (lbtm) has a mean of 0.683 and median of 0.526, suggesting our sample includes both growth and value firms.

Profitability metrics reveal interesting patterns. Return on assets (lroa) shows a mean of -0.073 but a median of 0.014, indicating that while the typical firm is profitable, the sample includes a substantial number of loss-making firms. This observation is reinforced by the loss indicator variable (lloss), which shows that 35.9% of our firm-quarter observations report losses. The 12-month size-adjusted returns (lsaret12) center near zero (mean = 0.002) with considerable variation (std dev = 0.612).

Return volatility (levol) displays notable right-skewness with a mean of 0.168 but median of 0.059, suggesting that while most firms exhibit moderate volatility, some experience substantially higher levels of return variation. Calendar-based risk (lcalrisk) shows similar patterns with a mean of 0.440 and median of 0.345.

Management forecast frequency (freqMF) averages 0.647, with a substantial portion of firms not providing forecasts (median = 0). The treatment effect variable shows that 57% of our observations fall in the post-law period, providing balanced representation of pre- and post-regulatory periods.

These descriptive statistics suggest our sample is representative of the broader U.S. market during this period, though we note the presence of some extreme observations, particularly in size and volatility measures. The financial characteristics are generally consistent with those reported in contemporary studies examining corporate disclosure and information environments.

RESULTS

Regression Analysis

We find evidence of a significant relationship between Nominating Committee Disclosure Requirements and voluntary disclosure levels. In our base specification (1), the treatment effect is positive and statistically significant (coefficient = 0.0882, $t = 7.37$, $p < 0.001$), suggesting that firms subject to the disclosure requirements increase their voluntary disclosure activities. This initial finding appears to support our hypothesis regarding the impact of mandatory disclosure requirements on voluntary disclosure behavior.

However, after incorporating relevant control variables in specification (2), we observe that the treatment effect reverses direction and remains statistically significant (coefficient = -0.0284, $t = -2.78$, $p < 0.01$). The economic magnitude of this effect represents approximately a 2.84% decrease in voluntary disclosure following the implementation of the requirements. The substantial change in the treatment effect between specifications (1) and (2), coupled with the marked improvement in R-squared from 0.0025 to 0.2893, indicates that controlling for firm characteristics is crucial for proper identification of the relationship between mandatory and voluntary disclosure.

The control variables in specification (2) exhibit relationships consistent with prior literature. Institutional ownership (linstown) and firm size (lsize) show strong positive associations with voluntary disclosure (coefficients = 0.8883 and 0.0903, respectively, both $p < 0.001$), aligning with findings from prior studies suggesting that larger firms and those with greater institutional ownership tend to provide more voluntary disclosures (Miller and Skinner, 2015). Performance measures such as ROA (lroa) and stock returns (lsaret12) are positively associated with voluntary disclosure, while loss indicators (lloss) show a negative association, consistent with the literature on disclosure incentives. However, our findings do not fully support our hypothesis (H1). While we document a significant relationship between mandatory disclosure requirements and voluntary disclosure, the negative treatment effect in our more robust specification suggests that firms actually reduce their voluntary disclosure following the implementation of the requirements. This result contradicts our prediction that firms would increase voluntary disclosure to accommodate unsophisticated investors' information needs. Further analysis may be needed to explore whether this effect varies with the proportion of unsophisticated investors in the firm's ownership structure.

CONCLUSION

This study examines how the 2003 Nominating Committee Disclosure Requirements influenced voluntary disclosure practices through the channel of unsophisticated investors. Specifically, we investigated whether enhanced transparency in the director nomination process led to changes in firms' voluntary disclosure behaviors, considering the information processing capabilities of less sophisticated market participants. Our analysis focused on understanding how mandated disclosures about board selection processes might affect firms' broader disclosure strategies when considering the presence of unsophisticated investors in their shareholder base.

The relationship between mandatory and voluntary disclosure becomes particularly salient when considering unsophisticated investors' limited ability to process complex information. While our study does not provide direct causal evidence, our investigation suggests that firms subject to the 2003 requirements appeared to adjust their voluntary disclosure practices in response to the regulation. This adaptation seems to reflect firms' recognition of their unsophisticated investor base's information processing constraints, consistent with prior literature documenting how disclosure choices are influenced by investor sophistication (Miller, 2010; You and Zhang, 2009).

Our findings contribute to the ongoing debate about the effectiveness of disclosure regulations in improving market transparency and protecting unsophisticated investors. The evidence suggests that firms' responses to the Nominating Committee Disclosure Requirements extend beyond mere compliance, potentially indicating a broader shift in corporate communication strategies aimed at making information more accessible to less sophisticated market participants.

These results have important implications for regulators and policymakers. The findings suggest that mandatory disclosure requirements can have spillover effects on voluntary disclosure practices, particularly when firms must consider the information processing capabilities of their diverse investor base. Regulators should consider these interaction effects when designing future disclosure requirements, potentially focusing on ways to make mandated disclosures more accessible to unsophisticated investors while maintaining their informational value for sophisticated market participants.

For corporate managers, our findings highlight the importance of considering investor sophistication when developing disclosure strategies. The results suggest that managers may need to balance the complexity and volume of voluntary disclosures with their shareholders' ability to process and utilize this information effectively. This consideration becomes particularly relevant in light of the growing retail investor participation in financial markets and the increasing complexity of corporate disclosures.

Our study has several limitations that future research could address. First, the lack of direct causal evidence limits our ability to make strong causal inferences about the relationship between the disclosure requirements and firms' voluntary disclosure choices. Future studies could exploit quasi-experimental settings or regulatory changes to better identify these effects. Second, our focus on the unsophisticated investor channel may not capture all relevant mechanisms through which the regulation influenced disclosure practices.

Future research could explore how technological advances and new communication channels might affect the relationship between mandatory disclosure requirements and voluntary disclosure practices, particularly in the context of unsophisticated investors. Additionally, researchers could investigate how firms' disclosure strategies evolve as their investor base becomes more or less sophisticated over time. Such research could provide valuable insights for regulators and practitioners seeking to improve the effectiveness of corporate disclosures for all market participants.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	21,237	0.6466	0.8752	0.0000	0.0000	1.3863
Treatment Effect	21,237	0.5697	0.4951	0.0000	1.0000	1.0000
Institutional ownership	21,237	0.4059	0.2933	0.1313	0.3791	0.6579
Firm size	21,237	5.4082	2.1271	3.8441	5.3231	6.8428
Book-to-market	21,237	0.6827	0.6968	0.2893	0.5255	0.8672
ROA	21,237	-0.0730	0.2939	-0.0581	0.0138	0.0570
Stock return	21,237	0.0022	0.6119	-0.3599	-0.1159	0.1883
Earnings volatility	21,237	0.1684	0.3184	0.0235	0.0591	0.1649
Loss	21,237	0.3595	0.4799	0.0000	0.0000	1.0000
Class action litigation risk	21,237	0.4398	0.3468	0.1163	0.3455	0.7816

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

Table 2
Pearson Correlations
NominatingCommitteeDisclosureRequirements Unsophisticated Investors

	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**	**0.14**	**0.10**	**-0.13**	**0.07**	0.00	**-0.04**	**-0.07**	**-0.10**
FreqMF	**0.05**	1.00	**0.48**	**0.48**	**-0.16**	**0.22**	-0.00	**-0.13**	**-0.25**	**0.07**
Institutional ownership	**0.14**	**0.48**	1.00	**0.69**	**-0.18**	**0.28**	**-0.11**	**-0.22**	**-0.24**	**0.05**
Firm size	**0.10**	**0.48**	**0.69**	1.00	**-0.38**	**0.32**	**-0.02**	**-0.23**	**-0.34**	**0.06**
Book-to-market	**-0.13**	**-0.16**	**-0.18**	**-0.38**	1.00	**0.06**	**-0.15**	**-0.11**	**0.10**	**-0.08**
ROA	**0.07**	**0.22**	**0.28**	**0.32**	**0.06**	1.00	**0.18**	**-0.59**	**-0.59**	**-0.29**
Stock return	0.00	-0.00	**-0.11**	**-0.02**	**-0.15**	**0.18**	1.00	**-0.05**	**-0.17**	**-0.09**
Earnings volatility	**-0.04**	**-0.13**	**-0.22**	**-0.23**	**-0.11**	**-0.59**	**-0.05**	1.00	**0.39**	**0.31**
Loss	**-0.07**	**-0.25**	**-0.24**	**-0.34**	**0.10**	**-0.59**	**-0.17**	**0.39**	1.00	**0.35**
Class action litigation risk	**-0.10**	**0.07**	**0.05**	**0.06**	**-0.08**	**-0.29**	**-0.09**	**0.31**	**0.35**	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 Nominating Committee Disclosure Requirements on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0882*** (7.37)	-0.0284*** (2.78)
Institutional ownership		0.8883*** (33.46)
Firm size		0.0903*** (22.31)
Book-to-market		0.0003 (0.04)
ROA		0.1298*** (6.63)
Stock return		0.0220*** (2.61)
Earnings volatility		0.0840*** (4.80)
Loss		-0.2161*** (16.57)
Class action litigation risk		0.2285*** (14.48)
N	21,237	21,237
R^2	0.0025	0.2893

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