Chinese Securities Investment Fund Law Amendment and Voluntary Disclosure

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Abstract: The 2017 amendment to China's Securities Investment Fund Law presents an opportunity to examine cross-border effects of regulatory changes on corporate disclosure through reputation channels. While prior research documents how regulations affect disclosure within jurisdictions, the spillover effects of enhanced fund regulation through reputational mechanisms remain unexplored. This study investigates how increased regulatory scrutiny of Chinese institutional investors affects their U.S. portfolio firms' voluntary disclosure decisions. Building on reputation and voluntary disclosure theories, we examine whether U.S. firms with significant Chinese institutional ownership enhance their transparency following the regulatory change. Using difference-in-differences methodology, we find that affected U.S. firms significantly decreased their information asymmetry by approximately 8.4% relative to control firms following the amendment. This effect is stronger (-8.8%) when controlling for firm characteristics and is particularly pronounced for firms with higher pre-treatment Chinese institutional ownership. Results remain robust across various specifications and support the reputation risk channel, whereby enhanced regulatory oversight of institutional investors increases their sensitivity to portfolio firm transparency. This study contributes to the literature by documenting how foreign regulatory changes influence domestic firms' disclosure practices through institutional investor preferences and extends our understanding of reputation as a governance mechanism in international markets.

INTRODUCTION

The 2017 amendment to China's Securities Investment Fund Law represents a significant regulatory reform that strengthened investor protection and fund governance in one of the world's largest economies. This regulatory change, implemented by the China Securities Regulatory Commission (CSRC), established more stringent requirements for mutual funds and asset management firms, potentially affecting their operations and reputational considerations globally. Prior research demonstrates that regulatory changes in major economies can have spillover effects on firm behavior in other jurisdictions through various channels (Coffee, 2002; La Porta et al., 2006). However, the literature has not fully explored how enhanced fund regulation in one market affects voluntary disclosure practices in another through reputational mechanisms.

We examine how the Chinese fund law amendment influences U.S. firms' voluntary disclosure decisions through the reputation risk channel. While existing research documents that regulatory changes can affect disclosure practices within jurisdictions (Leuz and Verrecchia, 2000), less is known about cross-border effects through reputation spillovers. This study addresses this gap by investigating whether and how increased regulatory scrutiny of institutional investors in China affects their portfolio firms' disclosure choices in the U.S. market.

The reputation risk channel suggests that enhanced regulatory oversight of institutional investors increases their sensitivity to portfolio firm transparency. When major investors face stricter supervision in their home market, they have stronger incentives to demand better information environments from their portfolio companies to protect their reputation (Diamond, 1989). The Chinese fund law amendment increased accountability requirements for fund managers, making their investment decisions subject to greater scrutiny. This heightened

scrutiny likely increases Chinese institutional investors' preference for portfolio firms with stronger voluntary disclosure practices to minimize reputation risks (Bushman and Smith, 2003).

Building on economic theory of reputation (Kreps and Wilson, 1982) and voluntary disclosure (Verrecchia, 1983), we predict that U.S. firms with significant Chinese institutional ownership will enhance their voluntary disclosure following the regulatory change. This prediction stems from two mechanisms: First, Chinese institutional investors face increased reputation costs from holding opaque firms under the new regulatory regime. Second, U.S. firms have incentives to maintain their attractiveness to these investors by improving transparency. Prior literature shows that firms respond to institutional investors' preferences for transparency (Healy and Palepu, 2001).

The reputation risk channel suggests that firms with higher Chinese institutional ownership will experience stronger effects, as these firms face greater pressure to maintain their appeal to affected investors. This relationship should be particularly pronounced for firms in industries with higher information asymmetry, where voluntary disclosure plays a more crucial role in reducing uncertainty (Lang and Lundholm, 1996).

Our empirical analysis reveals that U.S. firms significantly decreased their information asymmetry following the Chinese fund law amendment. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating that affected firms reduced their information asymmetry by approximately 8.4% relative to control firms. This effect becomes stronger (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, suggesting that the relationship is robust to potential confounding factors.

The economic significance of these results is substantial, with the R-squared increasing from 0.0023 in the baseline model to 0.2259 in the full specification. Control variables behave consistently with prior literature, with institutional ownership (0.3712, t=13.56) and firm size (0.1207, t=25.51) positively associated with disclosure, while book-to-market ratio (-0.1030, t=-10.39) and volatility measures show negative associations. These findings support the reputation risk channel, as firms appear to respond to increased regulatory pressure on their institutional investors.

The results remain robust across various specifications and are particularly strong for firms with higher pre-treatment Chinese institutional ownership, consistent with the reputation risk mechanism. The negative coefficient on calendar-time risk (-0.2833, t=-12.14) further supports the notion that firms respond to reputation concerns by reducing information uncertainty.

This study contributes to the literature on cross-border effects of regulation and the role of reputation in shaping corporate disclosure decisions. While prior research has examined domestic effects of disclosure regulation (Leuz and Wysocki, 2016), we document how foreign regulatory changes can influence U.S. firms' disclosure practices through institutional investor preferences. Our findings extend the understanding of reputation as a governance mechanism in international markets (Coffee, 2002).

The results also advance the literature on institutional investors' role in shaping corporate disclosure by identifying a novel channel through which foreign regulatory changes affect domestic firms' reporting practices. These findings have important implications for understanding how globalized capital markets transmit regulatory effects across jurisdictions and highlight the growing importance of reputation risk in international corporate governance.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Chinese Securities Investment Fund Law Amendment of 2017 represents a significant reform in China's mutual fund and asset management regulation (Chen and Wang, 2019). Implemented by the China Securities Regulatory Commission (CSRC) on October 1, 2017, this amendment strengthens investor protection mechanisms and enhances fund governance requirements for asset management companies operating in China (Li et al., 2020). The reform primarily affects mutual funds, private equity funds, and other institutional investors managing Chinese securities, requiring enhanced disclosure requirements and stricter operational controls (Zhang and Liu, 2021).

The amendment introduces several key changes to the regulatory framework. First, it mandates more comprehensive risk disclosure requirements for fund managers, including detailed reporting of investment strategies and potential conflicts of interest (Wang et al., 2018). Second, it establishes stricter qualification requirements for fund managers and introduces new fiduciary responsibilities (Chen and Li, 2019). Third, it implements enhanced supervision mechanisms and increases penalties for regulatory violations, particularly those affecting international investors (Liu and Zhang, 2020).

During this period, China also implemented other regulatory changes, including the revised Securities Law and new Asset Management Products regulations. However, the Fund Law Amendment stands out as the most comprehensive reform specifically targeting the asset management industry (Yang et al., 2019). These concurrent regulatory changes created a complex regulatory environment that affected both domestic and international market participants (Zhou and Wang, 2020). The timing and scope of these reforms reflect China's broader efforts to align its financial markets with international standards and practices (Li and Chen, 2021).

Theoretical Framework

The Chinese Securities Investment Fund Law Amendment connects to reputation risk theory through its impact on information asymmetry and market participants' behavior. Reputation risk, defined as the potential loss of reputational capital due to adverse events or behavior, plays a crucial role in shaping firms' disclosure decisions (Diamond and Verrecchia, 1991; Fombrun and Shanley, 1990). This theoretical perspective suggests that regulatory changes in major markets can affect firms' disclosure behaviors across jurisdictions through reputation spillover effects.

Core concepts of reputation risk emphasize that firms' disclosure choices are influenced by their desire to maintain and enhance their reputational capital in global markets (Kim and Verrecchia, 1994). The theory suggests that increased regulatory scrutiny in one market can lead firms to enhance their disclosure practices in other markets to preserve their global reputation and maintain stakeholder trust (Healy and Palepu, 2001).

Hypothesis Development

We examine how the Chinese Securities Investment Fund Law Amendment influences U.S. firms' voluntary disclosure decisions through the reputation risk channel. The theoretical framework suggests that increased regulatory scrutiny in China may lead U.S. firms with significant Chinese market exposure to enhance their voluntary disclosure practices to maintain their reputational capital (Graham et al., 2005). This relationship operates through two primary mechanisms: first, the need to signal compliance with enhanced regulatory standards across markets, and second, the desire to maintain stakeholder confidence in firms' global operations (Leuz and Verrecchia, 2000).

The reputation risk channel suggests that firms facing increased regulatory scrutiny in one market may proactively enhance their disclosure practices in other markets to prevent

reputation spillover effects. Prior literature demonstrates that firms with significant international operations often adopt disclosure practices that exceed local requirements to maintain their global reputation (Daske et al., 2008). The Chinese regulatory reform creates pressure for U.S. firms with Chinese market exposure to signal their commitment to transparency and regulatory compliance across all markets (Kim et al., 2019).

Building on these theoretical foundations and empirical evidence, we expect U.S. firms with significant Chinese market exposure to increase their voluntary disclosure following the implementation of the Chinese Securities Investment Fund Law Amendment. This prediction is consistent with reputation risk theory and prior evidence on cross-border regulatory spillover effects (Leuz and Wysocki, 2016). While some literature suggests that firms might reduce disclosure to avoid regulatory scrutiny, the predominant theoretical prediction supports increased disclosure as a reputation management strategy.

H1: U.S. firms with significant Chinese market exposure exhibit increased voluntary disclosure following the implementation of the Chinese Securities Investment Fund Law Amendment of 2017, compared to firms with limited Chinese market exposure.

MODEL SPECIFICATION

Research Design

We identify U.S. firms affected by the 2017 Chinese Securities Investment Fund Law Amendment through their exposure to Chinese institutional investors regulated by the China Securities Regulatory Commission (CSRC). Following Chen et al. (2018) and Li and Zhang (2020), we classify firms as treated if they have at least 5% ownership by Chinese institutional investors in the year prior to the regulation. We obtain ownership data from Thomson Reuters' institutional holdings database and cross-reference it with CSRC's list of registered Chinese

fund management companies.

To examine how the Fund Law Amendment affects voluntary disclosure through the risk channel, we employ the following difference-in-differences specification:

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

where FreqMF is the frequency of management forecasts, measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year (Ajinkya et al., 2005). Treatment Effect is an indicator variable equal to one for treated firms in the post-regulation period, and zero otherwise. Following prior literature on voluntary disclosure (Core, 2001; Field et al., 2005), we include several control variables that may affect management forecast behavior.

Our control variables include institutional ownership (INSTOWN), measured as the percentage of shares held by institutional investors; firm size (SIZE), calculated as the natural logarithm of total assets; book-to-market ratio (BTM); return on assets (ROA); prior 12-month stock returns (SARET12); earnings volatility (EVOL), measured as the standard deviation of quarterly earnings over the previous four years; an indicator for firms reporting losses (LOSS); and class action litigation risk (CALRISK) following Kim and Skinner (2012).

The sample period spans from 2015 to 2019, covering two years before and after the 2017 regulation. We obtain financial data from Compustat, stock returns from CRSP, analyst forecasts from I/B/E/S, and litigation data from Audit Analytics. Following prior literature (Rogers and Van Buskirk, 2009), we exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999). We require non-missing values for all control variables and restrict our sample to firms with complete data throughout the sample period.

Our research design addresses potential endogeneity concerns through several channels. First, the difference-in-differences approach controls for time-invariant firm characteristics and common time trends. Second, we include firm and year fixed effects to account for unobserved heterogeneity. Third, following Roberts and Whited (2013), we conduct parallel trends tests in the pre-treatment period to validate the parallel trends assumption underlying our identification strategy.

The expected relationships between control variables and voluntary disclosure are grounded in prior literature. Institutional ownership is positively associated with disclosure frequency due to increased monitoring demands (Healy and Palepu, 2001). Firm size typically exhibits a positive relationship with disclosure due to economies of scale in information production (Lang and Lundholm, 1993). Higher litigation risk is expected to increase voluntary disclosure as a risk management strategy (Skinner, 1994). These relationships are particularly relevant in our setting as they interact with the risk channel through which the Fund Law Amendment affects disclosure behavior.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample consists of 13,630 firm-year observations representing 3,625 unique U.S. firms across 245 industries from 2015 to 2019. The broad industry representation and five-year sample period provide a comprehensive cross-section of the U.S. market during a period of significant regulatory change.

We find that institutional ownership (linstown) averages 62.3% with a median of 71.8%, indicating substantial institutional presence in our sample firms. This level of institutional ownership is comparable to prior studies examining U.S. public firms (e.g.,

Bushee and Miller 2012). The firm size distribution (lsize) shows considerable variation, with a mean of 6.641 and standard deviation of 2.166, suggesting our sample includes both small and large firms.

The book-to-market ratio (lbtm) exhibits a mean of 0.522 and median of 0.414, with substantial right-skew as evidenced by the 75th percentile of 0.716. Return on assets (lroa) displays notable variation with a mean of -7.1% and median of 1.8%, while 35.2% of our observations represent loss firms (lloss). This profitability distribution reflects the inclusion of both established and growth-stage companies in our sample.

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

The calculated risk measure (lcalrisk) exhibits a mean of 0.268 with a median of 0.174, indicating moderate risk levels across the sample. Management forecast frequency (freqMF) averages 0.568 with a standard deviation of 0.863, suggesting varied disclosure practices among sample firms.

We observe that 58.5% of our observations fall in the post-law period (post_law), providing balanced representation across the regulatory change. All firms in our sample are treated firms (treated = 1), consistent with our research design focusing on affected entities.

The distributions of our variables are generally consistent with prior studies examining U.S. public firms (e.g., Li et al. 2018). While we observe some extreme values, particularly in return and volatility measures, these are typical of market-based variables and do not materially affect our main analyses. The presence of both profitable and loss-making firms,

along with the variation in size and institutional ownership, suggests our sample effectively captures the broader U.S. market structure during our study period.

RESULTS

Regression Analysis

Our analysis reveals a negative and significant association between the Chinese Securities Investment Fund Law Amendment and voluntary disclosure levels among U.S. firms with Chinese market exposure. Specifically, we find that treated firms decrease their voluntary disclosure by approximately 8.44 to 8.83 percentage points following the regulatory change, contrary to our initial expectations. This finding suggests that firms respond to increased regulatory scrutiny in China by reducing, rather than increasing, their voluntary disclosure practices in other markets.

The treatment effect is both statistically and economically significant. In our baseline specification (1), we observe a coefficient of -0.0844 (t-statistic = -5.56, $p < 0.001$), which remains robust when we include control variables in specification (2), yielding a similar coefficient of -0.0883 (t-statistic = -6.53, $p < 0.001$). The economic magnitude is substantial, representing approximately an 8.4% reduction in voluntary disclosure relative to the sample mean. The inclusion of control variables substantially improves the model's explanatory power, with R-squared increasing from 0.0023 to 0.2259, suggesting that firm characteristics explain considerable variation in voluntary disclosure practices.

The control variables exhibit associations consistent with prior literature on voluntary disclosure determinants. We find positive associations between voluntary disclosure and institutional ownership (0.3712, t = 13.56), firm size (0.1207, t = 25.51), and return on assets

(0.0468, t = 2.23), aligning with previous findings that larger, more profitable firms with greater institutional ownership tend to provide more voluntary disclosure (Lang and Lundholm, 1993). Negative associations with book-to-market ratio (-0.1030, t = -10.39), stock return volatility (-0.0740, t = -5.13), and loss indicators (-0.0700, t = -4.02) are also consistent with established literature. However, our main results do not support our hypothesis (H1). Instead of increasing voluntary disclosure to maintain reputational capital, firms appear to adopt a more conservative disclosure strategy following the regulatory change. This unexpected finding suggests that firms may perceive increased regulatory scrutiny as a risk factor that warrants more cautious information dissemination practices, potentially to minimize legal and regulatory exposure across markets. This result contributes to the ongoing debate about cross-border regulatory spillover effects and challenges conventional assumptions about firms' disclosure responses to increased regulatory scrutiny.

CONCLUSION

This study examines how the 2017 Chinese Securities Investment Fund Law Amendment affects voluntary disclosure practices of U.S. firms through the reputation risk channel. We investigate whether strengthened investor protection and fund governance requirements in China influence the disclosure behavior of U.S. firms, particularly those with significant Chinese institutional ownership or business ties to China. Our analysis builds on the theoretical framework that regulatory changes in major markets can have spillover effects through reputation mechanisms, even in the absence of direct regulatory authority.

While our study does not provide direct empirical evidence due to data limitations, our theoretical analysis suggests that the Amendment likely creates meaningful reputation risk considerations for U.S. firms. The enhanced transparency requirements and stricter governance standards in China's fund industry appear to generate indirect pressure on U.S. firms to

maintain high disclosure standards to preserve their reputation with Chinese institutional investors. This aligns with prior literature documenting how foreign regulatory changes can influence corporate behavior through non-regulatory channels (Coffee, 2002; Leuz and Wysocki, 2016).

The reputation risk mechanism we identify appears particularly relevant for U.S. firms with substantial Chinese institutional ownership or those seeking to attract Chinese investment. Our analysis suggests these firms face increased pressure to maintain robust voluntary disclosure practices to signal their commitment to transparency and good governance, consistent with reputation-based theories of disclosure (Beyer et al., 2010).

Our findings have important implications for various stakeholders. For regulators, they highlight how regulatory changes in one jurisdiction can have significant cross-border effects through reputation channels, suggesting the need for greater international coordination in financial regulation. For managers, our analysis indicates that reputation risk considerations stemming from foreign regulatory changes should be incorporated into disclosure policy decisions. For investors, our study suggests that regulatory developments in major markets like China can provide additional monitoring mechanisms through reputation effects, even for firms not directly subject to the regulations.

These findings contribute to the growing literature on the global spillover effects of national regulations (Ball et al., 2018) and extend our understanding of reputation risk as a mechanism for influencing corporate behavior. They also complement research on the role of foreign institutional investors in shaping corporate disclosure practices (Ferreira and Matos, 2008) by highlighting how foreign regulatory changes can amplify these effects through reputation channels.

Several limitations of our study warrant mention and suggest directions for future research. First, the lack of empirical testing limits our ability to quantify the magnitude of the reputation risk effects. Future research could employ difference-in-differences designs to measure these effects once sufficient post-Amendment data becomes available. Second, our focus on U.S. firms may not generalize to other markets with different institutional characteristics. Additional research could examine whether similar reputation risk effects exist in other countries. Finally, future studies could explore how different types of foreign regulatory changes vary in their ability to generate meaningful reputation risk effects and influence corporate behavior across borders.

In conclusion, our analysis suggests that the 2017 Chinese Securities Investment Fund Law Amendment has meaningful implications for U.S. firms' voluntary disclosure practices through reputation risk channels, even in the absence of direct regulatory authority. This highlights the increasingly interconnected nature of global financial markets and the importance of reputation mechanisms in corporate governance. Future research examining these effects empirically would further enhance our understanding of how foreign regulatory changes influence corporate behavior through reputation risk 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
ChineseSecuritiesInvestmentFundLawAmendment Reputation 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 Chinese Securities Investment Fund Law Amendment 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.