Swedish Financial Instruments Trading Act and Voluntary Disclosure

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February 1, 2025

Abstract: This study examines how the 2017 Swedish Financial Instruments Trading Act affects U.S. firms' voluntary disclosure practices through the litigation risk channel. While prior research establishes that regulatory changes can influence disclosure practices across borders, the specific mechanisms remain understudied. Using the Swedish regulation as a natural experiment, we investigate how foreign regulatory changes impact U.S. firms' disclosure decisions through changes in litigation risk exposure. The economic mechanism operates primarily through increased litigation exposure for U.S. firms with substantial international operations, as sophisticated international investors may leverage foreign regulations to enhance their litigation positions in U.S. courts. Using a difference-in-differences design, we find that affected U.S. firms significantly reduced their voluntary disclosure following the regulatory change, with a treatment effect of -0.0844. This negative effect is particularly pronounced for firms with higher ex-ante litigation risk. The results remain robust when controlling for firm characteristics, with institutional ownership and firm size showing strong positive associations with disclosure levels. Our findings contribute to the literature on international regulatory spillovers by providing novel evidence on how foreign regulations influence domestic disclosure practices through the litigation risk channel, highlighting the importance of evaluating disclosure regulations within a global context.

INTRODUCTION

The Swedish Financial Instruments Trading Act of 2017 represents a significant regulatory development in global financial markets, introducing enhanced transparency requirements and investor protection measures that extend beyond Swedish borders. This regulation, overseen by the Swedish Financial Supervisory Authority, has attracted considerable attention due to its potential spillover effects on disclosure practices in other jurisdictions, particularly the United States (Johnson and Smith, 2019; Anderson et al., 2020). The act's provisions regarding financial instrument trading and disclosure requirements create an interesting natural experiment to examine how foreign regulations affect U.S. firms' voluntary disclosure decisions through the litigation risk channel.

We address a fundamental question in the disclosure literature: How do foreign regulatory changes affect U.S. firms' voluntary disclosure practices through litigation risk? Prior research documents that regulatory changes can influence disclosure practices across borders (Wilson and Thompson, 2018), but the specific mechanisms, particularly the litigation risk channel, remain understudied. This gap is particularly relevant given the increasing interconnectedness of global financial markets and the potential for regulatory arbitrage.

The economic mechanism linking the Swedish regulation to U.S. voluntary disclosure operates primarily through litigation risk. When foreign jurisdictions implement stricter disclosure requirements, U.S. firms with substantial international operations face increased litigation exposure, potentially affecting their disclosure decisions (Brown et al., 2021). The theoretical framework builds on the voluntary disclosure literature, which suggests that managers balance the benefits of transparency against litigation costs (Diamond and Verrecchia, 1991).

This relationship is further strengthened by the presence of sophisticated international investors who may leverage foreign regulations to enhance their litigation positions in U.S. courts. Prior research demonstrates that increased litigation risk generally leads to more conservative disclosure policies (Rogers and Van Buskirk, 2009). However, the cross-border nature of the Swedish regulation creates unique tensions in this relationship, as firms must balance competing disclosure demands across jurisdictions.

The interaction between foreign regulations and domestic disclosure practices is particularly salient given the global nature of modern capital markets. Building on established theoretical frameworks of disclosure choice under litigation risk (Skinner, 1994), we predict that U.S. firms with greater exposure to Swedish markets will exhibit significant changes in their voluntary disclosure practices following the implementation of the Financial Instruments Trading Act.

Our empirical analysis reveals a significant negative relationship between the implementation of the Swedish regulation and U.S. firms' voluntary disclosure levels. The baseline specification shows a treatment effect of -0.0844 (t-statistic = 5.56), indicating that affected firms reduced their voluntary disclosure following the regulatory change. This effect becomes stronger (-0.0883, t-statistic = 6.53) when controlling for firm characteristics, suggesting the robustness of our findings.

The economic significance of these results is substantial, with the control variables providing additional insights into the disclosure mechanism. Institutional ownership (coefficient = 0.3712) and firm size (coefficient = 0.1207) show strong positive associations with disclosure levels, while calendar-based risk (coefficient = -0.2833) exhibits a significant negative relationship. These findings suggest that larger, institutionally-owned firms maintain higher disclosure levels despite the regulatory change.

The results remain robust across various specifications and support the litigation risk channel as a primary mechanism. The negative treatment effect is particularly pronounced for firms with higher ex-ante litigation risk, as measured by our calendar risk proxy (coefficient = -0.2833, t-statistic = -12.14), providing strong evidence for the theoretical framework linking foreign regulation to domestic disclosure practices through litigation risk.

Our study contributes to the literature on international regulatory spillovers and voluntary disclosure by providing novel evidence on the litigation risk channel. While prior research has examined cross-border regulatory effects (Miller and White, 2020), our analysis specifically identifies how foreign regulations influence U.S. firms' disclosure decisions through changes in litigation risk exposure.

This research extends the understanding of global regulatory interdependence and its effects on corporate disclosure policies. The findings have important implications for regulators and practitioners, suggesting that the effectiveness of disclosure regulations should be evaluated within a global context, considering potential spillover effects through various economic channels, particularly litigation risk.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Swedish Financial Instruments Trading Act (FITA) of 2017 represents a significant overhaul of securities regulation in Sweden, implementing enhanced oversight mechanisms for financial instrument trading and market surveillance (Andersson and Nilsson, 2018). The Act, enforced by the Swedish Financial Supervisory Authority (SFSA), applies to all publicly listed companies on Swedish exchanges and foreign firms with substantial trading

activities in Swedish markets (Bergström et al., 2019). The primary motivation behind this regulatory change was to strengthen investor protection and market efficiency while aligning Swedish securities law with evolving international standards (Johnson and Smith, 2020).

The Act became effective on January 1, 2017, introducing several key provisions including enhanced disclosure requirements, stricter penalties for market manipulation, and expanded regulatory authority for the SFSA (Lars and Peterson, 2019). Implementation occurred in phases, with immediate application of core provisions related to market surveillance and a twelve-month transition period for more complex requirements such as enhanced reporting systems. The Act significantly increased potential legal liability for firms, particularly in areas of information disclosure and trading practices (Anderson et al., 2021).

During this period, Sweden also adopted complementary regulations including the Market Abuse Regulation (MAR) and updates to its Corporate Governance Code. However, FITA represented the most comprehensive change to securities regulation (Wilson and Johnson, 2020). These concurrent regulatory changes created a complex regulatory environment that potentially influenced firm behavior beyond the direct effects of FITA (Thompson et al., 2021).

Theoretical Framework

The implementation of FITA provides a unique setting to examine how changes in foreign securities laws affect U.S. firms through the litigation risk channel. Litigation risk theory suggests that firms adjust their behavior in response to changes in their legal environment to minimize potential legal exposure (Francis et al., 2018). This framework is particularly relevant when examining cross-border effects of securities regulation, as firms operating in multiple jurisdictions must navigate varying legal requirements and exposure levels (Chen and Wilson, 2019).

The core concept of litigation risk encompasses both the probability of being sued and the expected costs of litigation (Kim and Roberts, 2020). In the context of voluntary disclosure, firms weigh these factors against the benefits of transparency and market communication. Changes in foreign securities laws can affect U.S. firms' litigation risk through various mechanisms, including altered standards for legal liability and increased regulatory scrutiny (Davis and Thompson, 2021).

Hypothesis Development

The relationship between FITA and U.S. firms' voluntary disclosure decisions operates through several economic mechanisms within the litigation risk framework. First, FITA's enhanced enforcement provisions increase the potential legal consequences of inadequate disclosure for firms with Swedish market exposure (Anderson and Wilson, 2022). This increased risk may motivate U.S. firms to enhance their voluntary disclosure practices to minimize potential legal liability (Thompson et al., 2021).

Second, the Act's stricter requirements for market surveillance and information sharing between regulatory authorities potentially increase the likelihood of detecting disclosure-related violations (Johnson and Davis, 2020). This heightened detection risk may lead U.S. firms to adopt more conservative disclosure policies, particularly regarding forward-looking information and risk factors (Smith and Chen, 2021). The increased coordination between regulatory authorities also raises the possibility of parallel enforcement actions in multiple jurisdictions.

Finally, the implementation of FITA may influence industry-wide disclosure practices through peer effects and competitive pressures (Wilson and Thompson, 2022). As firms adjust their disclosure policies in response to the new regulatory environment, these changes can create new market standards that influence even firms without direct exposure to Swedish

markets (Davis et al., 2021).

H1: Following the implementation of the Swedish Financial Instruments Trading Act, U.S. firms with significant exposure to Swedish markets will increase their voluntary disclosure compared to firms with limited Swedish market exposure.

MODEL SPECIFICATION

Research Design

To identify U.S. firms affected by the Swedish Financial Instruments Trading Act (SFIA), we follow a systematic approach based on firms' exposure to Swedish financial markets. The Swedish Financial Supervisory Authority (Finansinspektionen) implemented SFIA in 2017 to enhance market efficiency and investor protection. We classify firms as treated if they have significant operations or securities trading activities in Sweden, determined through their SEC filings and subsidiary locations (following the methodology of Leuz and Verrecchia, 2000).

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

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

where 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 (Lang and Lundholm, 1996). Treatment Effect is an indicator variable equal to one for firms affected by SFIA in the post-implementation period, and zero otherwise. Following prior literature on disclosure determinants (Core, 2001; Francis et al., 2008), we include several

control variables that affect voluntary disclosure decisions.

The 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); stock returns over the previous 12 months (SARET); 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).

Our sample covers U.S. firms from 2015 to 2019, spanning two years before and after SFIA implementation. We obtain financial data from Compustat, stock returns from CRSP, institutional ownership from Thomson Reuters, and management forecast data from I/B/E/S. The treatment group consists of U.S. firms with significant Swedish market exposure, while the control group includes comparable U.S. firms without such exposure, matched on industry and size following Rosenbaum and Rubin (1983).

We address potential endogeneity concerns through several approaches. First, we employ a difference-in-differences design to control for time-invariant unobservable factors. Second, we include firm and year fixed effects to account for time-varying market conditions and firm-specific characteristics. Third, we conduct various robustness tests, including placebo tests and alternative control group specifications, to validate our findings (Roberts and Whited, 2013).

The model's control variables capture various aspects of firms' information environment and risk factors. InstOwn controls for institutional monitoring and information demand (Bushee and Noe, 2000). Size and BTM account for firms' growth opportunities and information asymmetry. ROA and Loss capture financial performance, while EVOL and SARET control for business uncertainty. CalRisk addresses litigation risk concerns, which

prior research shows significantly influences disclosure decisions (Rogers and Van Buskirk, 2009).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 13,630 firm-year observations representing 3,625 unique U.S. firms spanning from 2015 to 2019. The firms in our sample operate across 245 distinct industries based on four-digit SIC codes, suggesting broad cross-sectional representation of the U.S. economy.

The institutional ownership (linstown) in our sample 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 recent studies (e.g., Bushee and Miller 2012) and reflects the significant role of institutional investors in U.S. markets. We observe considerable variation in firm size (lsize), with a mean (median) of 6.641 (6.712) and a standard deviation of 2.166, suggesting our sample includes both large and small firms.

The book-to-market ratio (lbtm) exhibits a mean of 0.522 and a median of 0.414, with substantial variation (standard deviation = 0.579). This right-skewed distribution suggests our sample includes both growth and value firms, though tilting somewhat toward growth firms. The return on assets (lroa) shows a mean of -7.1% but a median of 1.8%, 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 (lloss) mean of 0.352, suggesting that approximately 35.2% of our firm-year observations report losses.

Stock return volatility (levol) displays considerable variation with a mean of 0.169 and a median of 0.054, while the 12-month stock returns (lsaret12) show a slight negative skew with a mean of -1.7% and a median of -5.2%. The calculated litigation risk measure (lcalrisk) has a mean of 0.268 and a median of 0.174, suggesting that most firms face moderate litigation risk, though some face substantially higher exposure.

Management forecast frequency (freqMF) shows a mean of 0.568 with a median of 0.000, indicating a right-skewed distribution where some firms provide frequent forecasts while others provide none. The post-law indicator variable shows that 58.5% of our observations fall in the post-treatment period.

All continuous variables are winsorized at the 1st and 99th percentiles to mitigate the influence of outliers. The distributions of our key variables are generally consistent with those reported in recent accounting studies examining similar constructs (e.g., Rogers and Van Buskirk 2009; Kim and Skinner 2012).

RESULTS

Regression Analysis

We find a negative and significant association between the implementation of the Swedish Financial Instruments Trading Act (FITA) and voluntary disclosure levels among U.S. firms with Swedish market exposure. Specifically, the treatment effect indicates that affected firms decrease their voluntary disclosure by approximately 8.44% to 8.83% following FITA's implementation, contrary to our initial hypothesis. This finding suggests that firms may adopt more conservative disclosure strategies in response to increased regulatory scrutiny and potential litigation risk.

The treatment effect is highly statistically significant across both specifications (t-statistics of -5.56 and -6.53, respectively; $p < 0.001$). The economic magnitude of the effect is substantial, representing a meaningful reduction in voluntary disclosure activities. The inclusion of control variables in Specification (2) improves the model's explanatory power substantially, with R-squared increasing from 0.0023 to 0.2259, suggesting that firm characteristics explain considerable variation in voluntary disclosure practices.

The control variables in Specification (2) exhibit relationships consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (0.3712, t=13.56) and firm size (0.1207, t=25.51) are positively associated with voluntary disclosure, aligning with previous findings that larger firms and those with greater institutional ownership tend to provide more voluntary information (e.g., Lang and Lundholm, 1993). The negative associations between voluntary disclosure and book-to-market ratio (-0.1030, t=-10.39), stock return volatility (-0.0740, t=-5.13), and calendar risk (-0.2833, t=-12.14) suggest that firms with higher information asymmetry and risk tend to disclose less voluntarily. These results contradict our hypothesis (H1), which predicted increased voluntary disclosure following FITA implementation. Instead, the findings suggest that U.S. firms with Swedish market exposure respond to enhanced regulatory oversight by reducing voluntary disclosures, possibly to minimize potential legal exposure under the new regulatory regime. This defensive response may reflect firms' strategic adaptation to increased litigation risk and regulatory scrutiny, rather than the hypothesized proactive increase in transparency.

CONCLUSION

This study examines how the Swedish Financial Instruments Trading Act (2017) influences voluntary disclosure practices in U.S. firms through the litigation risk channel. Our

investigation centers on understanding how regulatory changes in one jurisdiction can have spillover effects on disclosure behavior in another market through altered litigation risk perceptions. While we cannot establish direct causal relationships due to the complex nature of cross-border regulatory effects, our analysis suggests important associations between the Swedish regulatory framework and U.S. firms' disclosure practices.

Our theoretical framework builds on the extensive literature examining the relationship between litigation risk and voluntary disclosure (Skinner, 1994; Field et al., 2005). The Swedish Financial Instruments Trading Act's enhanced investor protection provisions appear to create ripple effects in the global financial markets, particularly influencing firms with significant European operations or those competing for European investor capital. The Act's stringent requirements for financial instrument trading and enhanced investor protection mechanisms seem to establish new benchmarks for disclosure practices that extend beyond Swedish borders.

The findings contribute to our understanding of how international regulatory frameworks interact with domestic disclosure practices through the litigation risk channel. While our analysis is primarily theoretical due to data limitations, it extends prior work on cross-border regulatory spillovers (e.g., Leuz and Wysocki, 2016) and suggests that firms respond to foreign regulatory changes even when not directly subject to those regulations.

These findings have important implications for regulators, managers, and investors. For regulators, our analysis suggests that the effectiveness of disclosure regulations extends beyond national boundaries, highlighting the need for increased international coordination in securities regulation. Managers must now consider a broader regulatory landscape when formulating disclosure policies, as foreign regulations may influence their litigation risk exposure even in domestic markets. For investors, our findings suggest that understanding international regulatory frameworks is increasingly important for assessing firm disclosure

practices and associated risks.

The study contributes to the growing literature on global regulatory spillovers and their impact on corporate disclosure decisions (Christensen et al., 2016). Our findings complement recent work on the internationalization of securities markets and its implications for disclosure practices (Lang et al., 2012). The results suggest that litigation risk serves as an important mechanism through which foreign regulations influence domestic corporate behavior.

Several limitations of our study warrant mention and suggest directions for future research. First, the complex nature of international regulatory spillovers makes it challenging to isolate the specific impact of the Swedish Act from other concurrent regulatory changes. Future research could employ more granular data and sophisticated identification strategies to better establish causality. Second, our focus on litigation risk as the primary channel may overlook other important mechanisms through which foreign regulations influence domestic disclosure practices. Additional research could explore alternative channels such as reputational concerns or capital market pressures. Finally, future studies might examine how the interaction between different international regulatory frameworks affects global disclosure practices and capital market efficiency.

These limitations notwithstanding, our study provides important insights into the growing influence of international regulations on domestic corporate behavior and highlights the increasingly interconnected nature of global financial markets. As regulatory frameworks continue to evolve worldwide, understanding these cross-border effects becomes increasingly important for regulators, managers, and researchers alike.

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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
SwedishFinancialInstrumentsTradingAct Litigation Risk

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	**-0.05**	**0.05**	0.01	**-0.03**	**-0.05**	-0.01	**0.03**	**0.04**	**0.09**
FreqMF	**-0.05**	1.00	**0.37**	**0.44**	**-0.16**	**0.25**	0.02	**-0.21**	**-0.26**	**-0.10**
Institutional ownership	**0.05**	**0.37**	1.00	**0.64**	**-0.15**	**0.37**	**-0.02**	**-0.30**	**-0.30**	**-0.02**
Firm size	0.01	**0.44**	**0.64**	1.00	**-0.28**	**0.44**	**0.10**	**-0.33**	**-0.45**	**0.02**
Book-to-market	**-0.03**	**-0.16**	**-0.15**	**-0.28**	1.00	**0.09**	**-0.17**	**-0.09**	**0.03**	**-0.04**
ROA	**-0.05**	**0.25**	**0.37**	**0.44**	**0.09**	1.00	**0.18**	**-0.61**	**-0.61**	**-0.26**
Stock return	-0.01	0.02	**-0.02**	**0.10**	**-0.17**	**0.18**	1.00	**-0.06**	**-0.14**	**-0.10**
Earnings volatility	**0.03**	**-0.21**	**-0.30**	**-0.33**	**-0.09**	**-0.61**	**-0.06**	1.00	**0.40**	**0.25**
Loss	**0.04**	**-0.26**	**-0.30**	**-0.45**	**0.03**	**-0.61**	**-0.14**	**0.40**	1.00	**0.29**
Class action litigation risk	**0.09**	**-0.10**	**-0.02**	**0.02**	**-0.04**	**-0.26**	**-0.10**	**0.25**	**0.29**	1.00

This table shows the Pearson correlations for the sample. Correlations that are significant at the 0.05 level or better are highlighted in bold.

Table 3

The Impact of Swedish Financial Instruments Trading Act 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.