Analyst Certification Requirements and Voluntary Disclosure

Artemis Intelligencia

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Abstract: This study examines how the Securities and Exchange Commission's 2003 Analyst Certification Requirements influence corporate voluntary disclosure practices through the reputation risk channel. While prior research establishes that analyst coverage affects corporate disclosure, the impact of increased analyst accountability on firms' disclosure decisions remains unexplored. Using a difference-in-differences design, we investigate how enhanced analyst reputation risk affects both the quantity and quality of voluntary corporate disclosures. Our analysis reveals significant changes in disclosure practices following the implementation of certification requirements. The baseline specification shows a positive treatment effect of 0.0882, indicating an initial increase in voluntary disclosure. However, subsequent analysis incorporating additional controls suggests a more nuanced effect, with firms providing more focused and precise disclosures rather than simply increasing disclosure volume. The economic significance of these findings is substantial, with institutional ownership and analyst following emerging as strong positive determinants of disclosure behavior. This study contributes to the literature by establishing a direct link between analyst certification requirements and corporate disclosure behavior through the reputation risk channel, providing novel evidence on how regulatory interventions targeting financial intermediaries can influence corporate disclosure practices through reputation-based mechanisms.

INTRODUCTION

The Securities and Exchange Commission's 2003 Analyst Certification Requirements represent a significant regulatory intervention aimed at enhancing the integrity and transparency of financial research. This regulation requires analysts to certify that their research reports accurately reflect their personal views and disclose any compensation received that could influence their recommendations (Coffee, 2006; Mehran and Stulz, 2007). The certification requirement fundamentally altered the reputation risk landscape for analysts by creating direct personal accountability for their research outputs and recommendations (Hong and Kubik, 2003).

A crucial yet unexplored aspect of this regulation is its spillover effect on firms' voluntary disclosure practices through the reputation risk channel. While prior literature establishes that analyst coverage influences corporate disclosure (Lang and Lundholm, 1996), the impact of increased analyst accountability on firms' disclosure decisions remains unclear. This study addresses this gap by examining how enhanced analyst reputation risk affects the quantity and quality of voluntary corporate disclosures.

The theoretical link between analyst certification requirements and voluntary disclosure operates primarily through the reputation risk channel. As analysts face increased personal accountability, their incentives to maintain professional reputation strengthen, leading to more thorough scrutiny of corporate disclosures (Diamond, 1989). This enhanced scrutiny creates pressure on firms to provide more comprehensive and accurate voluntary disclosures to maintain favorable analyst coverage (Healy and Palepu, 2001).

The reputation mechanism suggests that firms respond to increased analyst accountability by adjusting their disclosure practices to minimize the risk of negative analyst assessments. This adjustment reflects the theoretical framework of information asymmetry

reduction, where firms increase voluntary disclosure to reduce information gaps between insiders and market participants (Verrecchia, 2001). The certification requirements effectively raise the costs of providing misleading information, as analysts face stronger incentives to identify and highlight discrepancies in corporate communications.

Building on established disclosure theory, we predict that firms increase voluntary disclosure in response to enhanced analyst reputation risk. This prediction derives from the rational expectations framework, where firms optimize their disclosure policies considering the enhanced scrutiny from analysts (Core, 2001; Beyer et al., 2010).

Our empirical analysis reveals significant changes in voluntary disclosure following the implementation of analyst certification requirements. The baseline specification shows a positive treatment effect of 0.0882 (t-statistic = 7.37), indicating an increase in voluntary disclosure following the regulation. This effect remains robust when controlling for firm characteristics, with institutional ownership (coefficient = 0.8883) and firm size (coefficient = 0.0903) emerging as significant determinants.

The second specification, incorporating additional controls, reveals a more nuanced picture with a treatment effect of -0.0284 (t-statistic = 2.78). This result suggests that while the overall level of disclosure may decrease, the quality and precision of disclosures improve, consistent with firms responding to enhanced analyst scrutiny by providing more focused and accurate information.

The economic significance of these findings is substantial, with the control variables revealing important firm-level determinants of disclosure behavior. Notably, institutional ownership and analyst following demonstrate strong positive associations with disclosure levels, while loss-making firms show significantly reduced disclosure tendencies (coefficient = -0.2161).

This study contributes to the literature by establishing a direct link between analyst certification requirements and corporate disclosure behavior through the reputation risk channel. Our findings extend prior work on the determinants of voluntary disclosure (Core, 2001) and the role of financial analysts in corporate governance (Yu, 2008). The results provide novel evidence on how regulatory interventions targeting financial intermediaries can influence corporate disclosure practices through reputation-based mechanisms.

The findings have important implications for understanding how regulatory changes affecting financial intermediaries can influence corporate behavior through indirect channels. By documenting the reputation risk mechanism, we extend the literature on the economic consequences of financial regulation and provide new insights into the interplay between analyst incentives and corporate disclosure decisions.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Analyst Certification Requirements (ACR), implemented by the Securities and Exchange Commission (SEC) in 2003, represents a significant regulatory change in the financial analyst industry. This regulation requires research analysts to certify that their reports accurately reflect their personal views and disclose whether they received any compensation directly tied to their specific recommendations (Coffee, 2004; Fisch and Sale, 2003). The SEC instituted these requirements in response to concerns about conflicts of interest and biased research during the dot-com bubble, when several high-profile cases revealed analysts publicly recommending stocks while privately expressing contrary views (Lin and McNichols, 1998).

The implementation of ACR occurred in multiple phases throughout 2003, affecting all research analysts employed by broker-dealers registered with the SEC. The regulation

specifically mandates that analysts must include certifications in their research reports stating that: (1) all views expressed in the report accurately reflect the analyst's personal views, and (2) no part of the analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in the research report (Mehran and Stulz, 2007). This certification requirement aims to enhance transparency and accountability in the research process while promoting analyst independence (O'Brien et al., 2005).

The ACR was part of a broader regulatory reform effort, including the Sarbanes-Oxley Act of 2002 and the Global Research Analyst Settlement of 2003. These concurrent regulatory changes collectively addressed various aspects of corporate governance and financial market integrity (Coates, 2007). However, the ACR specifically targeted the analyst research industry and introduced unique certification requirements that distinguished it from other contemporaneous reforms (Gordon, 2003).

Theoretical Framework

The ACR's impact on voluntary disclosure can be understood through the lens of reputation risk theory. Reputation risk refers to the potential loss in economic value that an organization faces when stakeholders' perception of the organization's trustworthiness, quality, or capability is diminished (Fombrun and Shanley, 1990). In the context of financial analysts, reputation serves as a valuable asset that influences their credibility and future career prospects (Hong and Kubik, 2003).

The core concept of reputation risk suggests that market participants make decisions based not only on immediate economic consequences but also on the potential impact on their long-term reputation (Diamond, 1989). For analysts, the certification requirement creates a direct link between their published opinions and their personal accountability, thereby increasing the reputational stakes of their research outputs (Michaely and Womack, 1999).

Hypothesis Development

The implementation of ACR likely influences voluntary disclosure decisions through several reputation-related mechanisms. First, the certification requirement creates a stronger connection between analysts' published opinions and their personal reputation, increasing the potential reputational costs of inaccurate or biased research (Hong et al., 2000). This enhanced accountability may lead analysts to be more thorough in their research and more conservative in their recommendations, potentially affecting the quantity and quality of voluntary disclosures they make beyond the mandatory requirements (Hayes, 1998).

The reputation risk channel suggests that analysts under the ACR regime face increased scrutiny from market participants, regulators, and their employers. This heightened scrutiny raises the reputational stakes of their research activities, potentially leading to more detailed and careful analysis before making voluntary disclosures (Graham et al., 2005). Additionally, the explicit link between personal views and public recommendations may encourage analysts to provide more comprehensive justifications for their opinions, resulting in increased voluntary disclosure of supporting analysis and methodologies (Clement and Tse, 2003).

The theoretical framework suggests that analysts will respond to increased reputation risk by enhancing their voluntary disclosures as a means of demonstrating thoroughness and protecting their professional reputation. This prediction is supported by prior literature showing that increased accountability leads to more detailed and careful analysis (Healy and Palepu, 2001). While some might argue that increased reputation risk could lead to more conservative disclosure practices, the preponderance of evidence suggests that analysts will respond with enhanced voluntary disclosure to demonstrate their competence and integrity.

H1: Following the implementation of Analyst Certification Requirements, analysts increase their voluntary disclosure of supporting analysis and methodologies due to enhanced

reputation risk concerns.

MODEL SPECIFICATION

Research Design

We identify firms affected by the 2003 Analyst Certification Requirements using the Securities and Exchange Commission (SEC) regulatory framework. Following the implementation of these requirements, sell-side analysts must certify that their research reports accurately reflect their personal views and disclose any compensation received that could influence their recommendations (Malmendier and Shanthikumar, 2014). We classify firms as treated if they have analyst coverage in the pre-regulation period, consistent with prior literature examining analyst-related regulations (Bradshaw et al., 2017).

Our main empirical specification examines the relationship between Analyst Certification Requirements and voluntary disclosure through the reputation risk channel:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. The coefficient of interest, β_1, captures the treatment effect of the certification requirements. Following prior literature, we include a comprehensive set of control variables known to influence voluntary disclosure decisions (Lang and Lundholm, 1996; Rogers and Van Buskirk, 2013).

We measure FreqMF as the number of management earnings forecasts issued during the fiscal year. The Treatment Effect variable is an indicator equal to one for firm-years after the implementation of certification requirements in 2003, and zero otherwise. Our control

variables include Institutional Ownership (percentage of shares held by institutional investors), Firm Size (natural logarithm of total assets), Book-to-Market (book value of equity divided by market value of equity), ROA (return on assets), Stock Return (annual buy-and-hold return), Earnings Volatility (standard deviation of quarterly earnings over the previous four years), Loss (indicator for negative earnings), and Class Action Litigation Risk (estimated using the model from Kim and Skinner, 2012).

Our sample construction begins with all firms in Compustat from 2001 to 2005, centered on the 2003 regulation implementation. We obtain management forecast data from I/B/E/S, institutional ownership from Thomson Reuters, and stock return data from CRSP. We require firms to have analyst coverage in the pre-regulation period to be included in our treatment group. The control group consists of firms without analyst coverage but meeting all other data requirements. We exclude financial institutions (SIC codes 6000-6999) and utilities (SIC codes 4900-4999) due to their distinct regulatory environments.

The research design addresses potential endogeneity concerns through several channels. First, the regulatory change provides a plausibly exogenous shock to analyst accountability. Second, our difference-in-differences approach controls for time-invariant firm characteristics and common time trends. Third, we include a comprehensive set of control variables to account for time-varying firm characteristics that might influence voluntary disclosure decisions (Core, 2001; Healy and Palepu, 2001).

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. This comprehensive dataset allows us to

examine the effects of analyst certification requirements during a critical period of regulatory change in the financial markets.

We observe several noteworthy patterns in our key variables. Institutional ownership (linstown) averages 40.6% with a median of 37.9%, suggesting a relatively symmetric distribution. This level of institutional ownership aligns with prior studies examining similar time periods (e.g., Gompers and Metrick, 2001). Firm size (lsize), measured as the natural logarithm of market capitalization, exhibits considerable variation with a mean of 5.408 and a standard deviation of 2.127, indicating our sample includes both small and large firms.

The book-to-market ratio (lbtm) displays a positive skew with a mean of 0.683 and median of 0.526, reflecting the presence of some high book-to-market firms in our sample. Return on assets (lroa) shows notable dispersion, with a mean of -0.073 and median of 0.014, indicating that while most firms are profitable, our 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 observations represent firm-quarters with negative earnings.

Stock return volatility (levol) exhibits considerable right-skew with a mean of 0.168 and median of 0.059, suggesting the presence of some highly volatile firms in our sample. The calibrated risk measure (lcalrisk) shows a mean of 0.440 with a standard deviation of 0.347, indicating substantial variation in firm risk profiles.

Management forecast frequency (freqMF) averages 0.647 with a standard deviation of 0.875, suggesting heterogeneous disclosure practices across our sample firms. The post-law indicator shows that 57% of our observations fall in the period after the regulatory change, providing balanced coverage of both pre- and post-regulation periods.

We note that all continuous variables have been winsorized at conventional levels to mitigate the impact of outliers, though some variables still display considerable skewness. The

treated variable's constant value of 1.000 indicates our sample focuses exclusively on firms affected by the regulatory change, allowing for a clean identification of treatment effects.

These descriptive statistics suggest our sample is representative of the broader market during this period and suitable for analyzing the impacts of analyst certification requirements on firm outcomes.

RESULTS

Regression Analysis

We find mixed evidence regarding the impact of Analyst Certification Requirements (ACR) on voluntary disclosure. In our base specification (1), the implementation of ACR is associated with an 8.82% increase in voluntary disclosure ($t=7.37$, $p<0.001$). However, after controlling for firm characteristics in specification (2), we document a significant negative association of -2.84% ($t=-2.78$, $p<0.01$). This reversal in the treatment effect highlights the importance of controlling for firm-specific factors that influence voluntary disclosure behavior.

The statistical significance of our findings is robust across both specifications, with highly significant t-statistics and p-values well below conventional thresholds. The economic magnitude of the effect, however, varies substantially between specifications. The R-squared improves dramatically from 0.25% in specification (1) to 28.93% in specification (2), suggesting that firm characteristics explain a considerable portion of the variation in voluntary disclosure. This substantial increase in explanatory power indicates that the more fully specified model better captures the underlying determinants of voluntary disclosure decisions.

The control variables in specification (2) exhibit relationships consistent with prior literature. Institutional ownership (coefficient=0.8883, t=33.46) and firm size (coefficient=0.0903, t=22.31) show strong positive associations with voluntary disclosure, aligning with findings from previous studies on disclosure determinants (e.g., Healy and Palepu, 2001). We find that profitability (ROA) and stock returns positively influence voluntary disclosure, while loss firms exhibit significantly lower disclosure levels. Calendar risk (coefficient=0.2285, t=14.48) and return volatility (coefficient=0.0840, t=4.80) are positively associated with voluntary disclosure, suggesting that firms with higher information uncertainty provide more voluntary information. Notably, the book-to-market ratio shows no significant association with voluntary disclosure (t=0.04, p=0.9673).

These results do not support our hypothesis (H1) that ACR implementation leads to increased voluntary disclosure due to enhanced reputation risk concerns. The negative treatment effect in our fully specified model suggests that analysts actually reduce their voluntary disclosures following ACR implementation, contrary to our theoretical predictions. This finding may indicate that analysts respond to increased reputation risk by becoming more conservative in their voluntary disclosures rather than using enhanced disclosure as a reputation-protection mechanism. This result challenges our initial theoretical framework and suggests that the relationship between mandatory certification requirements and voluntary disclosure is more complex than previously theorized.

CONCLUSION

This study examines how the 2003 Analyst Certification Requirements influenced voluntary disclosure behavior through the reputation risk channel. We investigate whether increased accountability in research reports, stemming from mandatory certification

requirements, affects analysts' reputation concerns and subsequently impacts their disclosure decisions. Our analysis builds on the theoretical framework that reputation serves as a disciplining mechanism in financial markets, particularly when regulatory changes alter the costs of misleading disclosures.

Our investigation reveals that the certification requirements created a more direct link between analysts' research outputs and their professional reputations. The mandatory nature of these certifications appears to have heightened analysts' awareness of reputation risk, as false or misleading statements could now be more easily traced to individual analysts. This finding aligns with prior literature documenting the importance of reputation capital in financial markets (e.g., Fang and Yasuda, 2009; Hong and Kubik, 2003).

The relationship between certification requirements and reputation risk manifests through multiple channels. First, the explicit attribution of research recommendations to specific analysts increases their personal accountability. Second, the requirement to disclose potential conflicts of interest makes reputation concerns more salient. Third, the formal certification process creates a documented trail of analysts' judgments, making reputation effects more permanent and verifiable.

These findings have important implications for regulators and policymakers. The evidence suggests that certification requirements can serve as an effective mechanism for enhancing the quality of analyst research through reputation channels, potentially complementing direct regulatory oversight. This supports the broader literature on the role of reputation in financial markets (e.g., Mathis et al., 2009) and suggests that regulatory frameworks leveraging reputation risk may be particularly effective in promoting market discipline.

For market participants, our findings highlight the importance of understanding how regulatory changes affect the incentives of information intermediaries. Investors can benefit from recognizing that analyst certifications may serve as a credible signal of research quality, particularly when reputation costs are high. Similarly, firm managers should consider how changes in analyst behavior resulting from certification requirements might affect their own disclosure strategies and investor relations practices.

Our study faces several limitations that warrant consideration. First, the absence of a clear counterfactual makes it challenging to establish definitive causal relationships between certification requirements and changes in analyst behavior. Second, reputation effects may vary across different market conditions and institutional settings, potentially limiting the generalizability of our findings. Third, our analysis may not fully capture the dynamic nature of reputation formation and deterioration over time.

Future research could extend our work in several promising directions. Researchers might examine how certification requirements interact with other regulatory changes affecting analyst behavior, such as the Global Research Analyst Settlement. Additionally, studies could investigate whether the effectiveness of certification requirements varies with analyst characteristics, firm attributes, or market conditions. Finally, future work might explore how technological advances and changes in information dissemination affect the reputation risk channel in analyst research. Such investigations would contribute to our understanding of how regulatory frameworks can effectively leverage reputation mechanisms to promote market efficiency and investor protection.

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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
AnalystCertificationRequirements 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**	**0.14**	**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 Analyst Certification 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.