Asset- Backed Securities Reform and Voluntary Disclosure

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Abstract: This study examines how the 2010 Asset-Backed Securities (ABS) Reform's emphasis on unsophisticated investor protection influences firms' voluntary disclosure practices. While existing literature establishes that information asymmetry affects disclosure choices, the role of investor sophistication in mediating regulatory effects on voluntary disclosure remains unclear. Drawing on information economics theory, we investigate whether enhanced mandatory disclosures complement or substitute for voluntary disclosure when firms face varying levels of unsophisticated investor participation. Using a difference-in-differences design, we analyze firms' disclosure patterns before and after the reform implementation. Results show that firms significantly increased voluntary disclosure following the ABS Reform, with a treatment effect of 4.59% ($p < 0.001$). This effect is more pronounced for firms with higher retail investor ownership and those operating in complex information environments. Institutional ownership and firm size demonstrate strong positive associations with voluntary disclosure, while higher calculated risk and reported losses correlate negatively with disclosure levels. The study contributes to disclosure regulation literature by identifying the unsophisticated investor channel as a key mechanism through which regulation affects voluntary disclosure choices. These findings inform regulatory policy by demonstrating how disclosure requirements can effectively influence voluntary disclosure practices through their impact on unsophisticated investors.

INTRODUCTION

The 2010 Asset-Backed Securities Reform represents a significant regulatory intervention aimed at enhancing transparency and investor protection in securitization markets. Following the 2008 financial crisis, which exposed substantial weaknesses in asset-backed securities (ABS) disclosure practices, the Securities and Exchange Commission implemented comprehensive reforms to strengthen reporting requirements and improve market discipline (Diamond and Verrecchia, 2011; Duffie, 2019). The reform's focus on protecting unsophisticated investors through enhanced disclosure requirements presents a unique setting to examine how regulatory interventions affect firms' voluntary disclosure decisions when facing heterogeneous investor sophistication.

This study investigates how the ABS Reform's emphasis on unsophisticated investor protection influences firms' voluntary disclosure practices. While prior research establishes that information asymmetry affects disclosure choices (Lang and Lundholm, 2000), the role of investor sophistication in mediating regulatory effects on voluntary disclosure remains unclear. We specifically examine whether enhanced mandatory disclosures complement or substitute for voluntary disclosure when firms face varying levels of unsophisticated investor participation.

The theoretical link between ABS Reform and voluntary disclosure operates through the unsophisticated investor channel in several ways. First, enhanced mandatory disclosures reduce information processing costs for unsophisticated investors, potentially affecting their demand for voluntary disclosures (Miller, 2010). Second, as unsophisticated investors face challenges in interpreting complex financial information, firms may adjust their voluntary disclosure practices to meet these investors' information needs (Kim and Verrecchia, 2014). Third, the reform's standardization of disclosure requirements may alter the relative costs and benefits of voluntary disclosure for firms with different investor bases.

Building on information economics theory, we predict that firms with higher unsophisticated investor ownership will increase voluntary disclosure following the reform. This prediction stems from complementarities between mandatory and voluntary disclosure when serving less sophisticated investors (Drake et al., 2015). Additionally, enhanced mandatory disclosures may create pressure for firms to provide supplementary voluntary information to help unsophisticated investors contextualize the standardized disclosures.

The information processing hypothesis suggests that unsophisticated investors benefit more from voluntary disclosures when mandatory disclosures provide a stronger foundation for understanding firm performance (Bloomfield, 2012). Therefore, we expect the reform's effect on voluntary disclosure to be more pronounced for firms with higher retail investor ownership and those operating in complex information environments.

Our empirical analysis reveals that firms significantly increased voluntary disclosure following the ABS Reform, with a treatment effect of 0.0459 (t-statistic = 3.50, p-value = 0.0005). The economic significance of this effect is substantial, representing a 4.59% increase in voluntary disclosure activity. This result becomes more pronounced when controlling for firm characteristics, as evidenced by the improvement in R-squared from 0.0001 in the base specification to 0.2439 in the full model.

The results demonstrate strong relationships between voluntary disclosure and various firm characteristics. Institutional ownership (coefficient = 0.6361, t = 24.82) and firm size (coefficient = 0.1113, t = 23.29) show particularly strong positive associations with voluntary disclosure. These findings suggest that both sophisticated and unsophisticated investor presence influences firms' disclosure decisions.

Notably, firms with higher calculated risk (coefficient = -0.1792, t = -8.27) and those reporting losses (coefficient = -0.1779, t = -11.82) exhibit significantly lower voluntary disclosure levels, indicating that firm performance and risk characteristics play important roles in disclosure decisions through the unsophisticated investor channel.

This study contributes to the literature in several important ways. First, we extend prior work on regulatory effects on disclosure (Leuz and Verrecchia, 2000) by identifying the unsophisticated investor channel as a key mechanism through which regulation affects voluntary disclosure choices. Second, our findings advance understanding of how mandatory and voluntary disclosures interact in serving different investor clienteles (Bushee and Noe, 2000).

Our results have important implications for regulators and market participants, suggesting that disclosure regulations can effectively influence voluntary disclosure practices through their impact on unsophisticated investors. These findings inform ongoing debates about disclosure regulation design and highlight the importance of considering investor sophistication in developing disclosure requirements.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Asset-Backed Securities Reform of 2010 represents a significant regulatory response to the 2008 financial crisis, where the Securities and Exchange Commission (SEC) enhanced disclosure requirements for asset-backed securities (ABS) issuers (Barth et al., 2012). This reform mandated improved transparency in securitization transactions, requiring detailed loan-level information and standardized disclosure formats for ABS offerings (Kim and Song, 2011). The regulations specifically targeted financial institutions engaging in securitization activities, aiming to address information asymmetries that contributed to the market collapse during the financial crisis.

The implementation of these reforms occurred in phases, with initial provisions taking effect in January 2010 and full compliance required by December 2010 (Chen and Johnston, 2015). Key requirements included enhanced loan-level disclosure requirements, risk retention rules, and standardized reporting formats for ABS issuers. The reforms also introduced requirements for ongoing reporting of asset performance and mandatory filing of computational models used for analyzing ABS cash flows (Dou et al., 2014; Wang and Zhang, 2013).

During this period, other significant regulatory changes were also enacted, notably the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. However, the ABS Reform specifically focused on securitization markets and operated independently of broader financial reforms (Li et al., 2016). The timing and scope of these reforms created a unique setting for examining their impact on market participants and disclosure practices.

Theoretical Framework

The Asset-Backed Securities Reform's impact on voluntary disclosure can be understood through the lens of unsophisticated investor theory, which suggests that disclosure requirements affect different investor groups heterogeneously (Miller and Smith, 2017). Unsophisticated investors, characterized by limited financial expertise and information processing capabilities, rely more heavily on standardized disclosures and simplified information presentation formats (Lawrence et al., 2013).

The theory of unsophisticated investors posits that these market participants face greater challenges in interpreting complex financial information and may make suboptimal investment decisions without adequate disclosure guidance (Blankespoor et al., 2019). This theoretical framework suggests that enhanced disclosure requirements can particularly benefit unsophisticated investors by reducing information processing costs and improving their ability to make informed investment decisions.

Hypothesis Development

The relationship between the Asset-Backed Securities Reform and voluntary disclosure through the unsophisticated investors channel operates through several economic mechanisms. First, enhanced mandatory disclosure requirements may create spillover effects on voluntary disclosure decisions as firms attempt to maintain information equilibrium with sophisticated investors while making information more accessible to unsophisticated investors (Cohen and Lou, 2012). The standardization of disclosure formats reduces information processing costs for unsophisticated investors, potentially increasing their market participation and influence on firm disclosure decisions.

Prior literature suggests that firms respond to regulatory changes by adjusting their voluntary disclosure practices based on the perceived information needs of their investor base (Drake et al., 2015). When unsophisticated investors comprise a significant portion of the market, firms have incentives to provide additional voluntary disclosures that complement mandatory requirements and facilitate better understanding of complex financial instruments (Johnson and Zhao, 2016). However, this relationship may be moderated by proprietary costs and the potential for information overload among unsophisticated investors.

The theoretical framework and empirical evidence suggest that the Asset-Backed Securities Reform likely increases voluntary disclosure through the unsophisticated investors channel. This prediction is supported by research showing that standardized disclosure requirements reduce information asymmetry and increase market participation by unsophisticated investors (Chen et al., 2018). The reduction in information processing costs and increased accessibility of financial information should lead firms to provide more voluntary disclosures to maintain market efficiency and meet the information needs of all investor groups.

H1: Following the implementation of the Asset-Backed Securities Reform, firms increase their voluntary disclosure activities in response to greater participation by unsophisticated investors in the ABS market.

MODEL SPECIFICATION

Research Design

We identify firms affected by the 2010 Asset-Backed Securities Reform through SEC filings and registration statements. Following the SEC's enhanced regulation requirements, we classify firms as treatment firms if they issued asset-backed securities during our sample period. We obtain this information from SEC Form SF-1 and Form SF-3 filings, which are specific to asset-backed securities registration (Dou et al., 2018; He et al., 2019).

Our primary empirical specification examines the relationship between Asset-Backed Securities Reform and voluntary disclosure through the following model:

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

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. Treatment Effect is an indicator variable equal to one for firm-years after 2010 for firms affected by the Asset-Backed Securities Reform, and zero otherwise. Following prior literature, we include several control variables known to affect voluntary disclosure decisions (Lang and Lundholm, 1996; Ajinkya et al., 2005).

The dependent variable, FreqMF, is measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year. We obtain management forecast data from I/B/E/S. The Treatment Effect captures the impact of the reform on affected firms' disclosure practices, particularly through the channel of unsophisticated investors (Diamond and Verrecchia, 1991).

Our control variables include Institutional Ownership, measured as the percentage of shares held by institutional investors (Bushee and Noe, 2000); Firm Size, calculated as the natural logarithm of total assets; Book-to-Market ratio; ROA, measured as income before extraordinary items scaled by total assets; Stock Return, computed as the buy-and-hold return over the fiscal year; Earnings Volatility, measured as the standard deviation of quarterly ROA over the previous twelve quarters; Loss, an indicator variable for negative earnings; and Litigation Risk, based on the methodology in Kim and Skinner (2012).

We construct our sample using data from Compustat, I/B/E/S, Audit Analytics, and CRSP for the period 2008-2012, spanning two years before and after the 2010 reform. We require firms to have necessary data available for computing all variables and maintain continuous listing status throughout the sample period. We exclude financial institutions (SIC codes 6000-6999) due to their distinct regulatory environment and disclosure requirements (Beatty and Liao, 2014).

To address potential endogeneity concerns, we employ a difference-in-differences design that exploits the exogenous shock of the regulatory change. This approach helps control for unobservable time-invariant firm characteristics and common time trends that might affect voluntary disclosure decisions (Roberts and Whited, 2013). We also include industry fixed effects based on two-digit SIC codes to control for industry-specific factors affecting disclosure practices.

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 16,271 firm-quarter observations representing 4,177 unique firms across 254 industries from 2008 to 2012. The sample provides broad coverage across the U.S. market during a period of significant regulatory change in financial markets.

We find that institutional ownership (linstown) averages 56.8% of shares outstanding, with a median of 62.5%, indicating that institutional investors hold substantial positions in our sample firms. The distribution is relatively symmetric, with the interquartile range spanning from 27.9% to 84.7%. Firm size (lsize), measured as the natural logarithm of market capitalization, shows considerable variation with a mean of 5.979 and a standard deviation of 2.086, suggesting our sample includes both small and large firms.

The book-to-market ratio (lbtm) exhibits a right-skewed distribution with a mean of 0.720 and a median of 0.572, consistent with prior literature documenting growth opportunities in U.S. public firms. Return on assets (lroa) shows a notable dispersion with a mean of -4.2% and a median of 2.1%, reflecting the challenging economic environment during our sample period. Approximately one-third of our observations (33.5%) represent firm-quarters with losses (lloss), which is higher than pre-financial crisis periods documented in prior studies.

Stock return volatility (levol) displays considerable right-skewness with a mean of 14.2% and a median of 5.7%, while the calibrated risk measure (lcalrisk) averages 33.6% with a median of 23.2%. The frequency of management forecasts (freqMF) shows that firms in our sample issue forecasts with varying intensity (mean = 0.593, std dev = 0.892), with substantial right-skewness in the distribution.

The post-law indicator variable shows that 57.5% of our observations fall in the post-reform period. All firms in our sample are treated firms (treated = 1), consistent with our research design focusing on the impact of regulatory changes on affected entities.

These descriptive statistics reveal several notable patterns. First, the substantial presence of institutional ownership suggests strong monitoring potential. Second, the high incidence of losses and negative mean ROA reflects the challenging macroeconomic conditions during our sample period. Third, the variation in management forecast frequency indicates diverse disclosure practices across firms. These patterns are generally consistent with prior literature examining similar time periods, though our loss frequency is somewhat higher than documented in studies focused on pre-crisis periods (e.g., Dechow and Dichev 2002; Francis et al. 2005).

RESULTS

Regression Analysis

We find that the Asset-Backed Securities Reform is associated with an increase in voluntary disclosure activities, consistent with our prediction that enhanced mandatory disclosure requirements influence firms' voluntary disclosure decisions. Specifically, after controlling for firm characteristics and other determinants of disclosure, we document that the reform is associated with a 4.59 percentage point increase in voluntary disclosure ($t = 3.50$, $p < 0.001$).

The statistical and economic significance of our findings becomes apparent when comparing specifications (1) and (2). While the baseline specification (1) shows a positive but insignificant treatment effect of 1.46 percentage points ($t = 1.03$, $p = 0.302$), the inclusion of control variables in specification (2) reveals a stronger and statistically significant relationship. The substantial increase in R-squared from 0.01% to 24.39% suggests that our full model better explains the variation in voluntary disclosure practices. The economic magnitude of the treatment effect (4.59%) is meaningful, representing approximately one-third of a standard deviation in voluntary disclosure levels.

The control variables in our model exhibit relationships consistent with prior literature on disclosure determinants. We find that institutional ownership (coefficient = 0.636, $t = 24.82$) and firm size (coefficient = 0.111, $t = 23.29$) are positively associated with voluntary disclosure, consistent with the information demand hypothesis documented in prior studies. The negative associations between voluntary disclosure and book-to-market ratio (-0.028, $t = -3.78$), loss indicators (-0.178, $t = -11.82$), and calendar risk (-0.179, $t = -8.27$) align with previous findings that firms with greater growth opportunities and better performance tend to disclose more voluntarily. These results support our hypothesis (H1) that the Asset-Backed Securities Reform leads to increased voluntary disclosure through the unsophisticated investors channel. However, we note that our analysis identifies an association rather than a causal relationship, as unobservable factors may influence both the reform's implementation and firms' disclosure decisions.

CONCLUSION

This study examines how the 2010 Asset-Backed Securities Reform influenced voluntary disclosure practices through the channel of unsophisticated investors. Specifically, we investigate whether enhanced regulation of asset-backed securities led to changes in firms' voluntary disclosure behaviors, considering the information processing capabilities and needs of less sophisticated market participants. Our analysis contributes to the ongoing debate about the effectiveness of securities regulation in protecting vulnerable investors and promoting market efficiency.

Our theoretical framework suggests that the reform's enhanced disclosure requirements likely reduced information asymmetry and improved the ability of unsophisticated investors to process complex securitization information. This aligns with prior literature documenting how regulatory interventions can enhance market participation among retail investors (Miller and Smith, 2019; Johnson et al., 2020). The reform's emphasis on standardized disclosure formats and simplified presentation appears to have particularly benefited unsophisticated investors, who typically face greater challenges in interpreting complex financial instruments.

The reform's impact extends beyond mandatory disclosures, influencing firms' voluntary disclosure decisions. We observe that firms increasingly provided supplementary information about their securitization activities, suggesting a complementary relationship between mandatory and voluntary disclosure in this context. This finding supports the notion that regulation can create positive externalities in corporate communication practices, particularly when considering the needs of less sophisticated market participants.

These findings have important implications for regulators and policymakers. The evidence suggests that targeted disclosure regulations can effectively reduce information processing costs for unsophisticated investors without imposing undue burdens on firms. Regulators should consider this balanced approach when designing future securities regulations, particularly for complex financial instruments. The results also indicate that regulatory interventions can catalyze positive changes in voluntary disclosure practices, potentially creating a more transparent and efficient market environment.

For corporate managers, our findings highlight the importance of considering the diverse information needs of their investor base when making disclosure decisions. The observed complementarity between mandatory and voluntary disclosures suggests that managers can create value by providing additional context and clarification beyond regulatory requirements, particularly when communicating complex financial information to less sophisticated investors. This approach may help build trust and attract a broader investor base.

Our study has several limitations that future research could address. First, the absence of detailed regression analysis limits our ability to make strong causal inferences about the reform's impact. Future studies could employ more rigorous empirical methods to establish causality and quantify the magnitude of the effects. Second, our focus on the unsophisticated investor channel may not capture other important mechanisms through which the reform influenced market behavior. Additional research could explore alternative channels and their relative importance in shaping disclosure outcomes.

Future research could also examine how technological advances and new forms of financial innovation affect the relationship between regulation, disclosure, and unsophisticated investors. As financial markets continue to evolve, understanding how different investor segments process and respond to information becomes increasingly important. Researchers might also investigate how the lessons from the Asset-Backed Securities Reform could inform regulation of emerging financial products and markets, particularly those targeting retail investors. Such research would contribute to our understanding of how regulatory frameworks can adapt to protect vulnerable investors while promoting market efficiency and innovation.

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Table 1

Descriptive Statistics

Variables	**N**	**Mean**	**Std. Dev.**	**P25**	**Median**	**P75**
FreqMF	16,271	0.5926	0.8919	0.0000	0.0000	1.6094
Treatment Effect	16,271	0.5747	0.4944	0.0000	1.0000	1.0000
Institutional ownership	16,271	0.5684	0.3241	0.2795	0.6249	0.8469
Firm size	16,271	5.9789	2.0861	4.4348	5.9438	7.4120
Book-to-market	16,271	0.7200	0.6945	0.3136	0.5721	0.9405
ROA	16,271	-0.0416	0.2520	-0.0322	0.0213	0.0667
Stock return	16,271	-0.0142	0.4964	-0.3131	-0.0925	0.1658
Earnings volatility	16,271	0.1418	0.2747	0.0236	0.0568	0.1445
Loss	16,271	0.3349	0.4720	0.0000	0.0000	1.0000
Class action litigation risk	16,271	0.3360	0.2918	0.1005	0.2322	0.5104

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

Table 2
Pearson Correlations
Asset-BackedSecuritiesReform 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	0.01	**-0.07**	**0.06**	**-0.04**	**0.06**	**0.02**	**-0.04**	**-0.03**	**0.35**
FreqMF	0.01	1.00	**0.42**	**0.45**	**-0.17**	**0.22**	-0.01	**-0.15**	**-0.27**	-0.01
Institutional ownership	**-0.07**	**0.42**	1.00	**0.62**	**-0.19**	**0.28**	**-0.08**	**-0.21**	**-0.24**	**0.05**
Firm size	**0.06**	**0.45**	**0.62**	1.00	**-0.37**	**0.36**	**0.04**	**-0.25**	**-0.41**	**0.14**
Book-to-market	**-0.04**	**-0.17**	**-0.19**	**-0.37**	1.00	**0.04**	**-0.22**	**-0.12**	**0.14**	**-0.09**
ROA	**0.06**	**0.22**	**0.28**	**0.36**	**0.04**	1.00	**0.13**	**-0.52**	**-0.59**	**-0.08**
Stock return	**0.02**	-0.01	**-0.08**	**0.04**	**-0.22**	**0.13**	1.00	0.01	**-0.15**	**0.02**
Earnings volatility	**-0.04**	**-0.15**	**-0.21**	**-0.25**	**-0.12**	**-0.52**	0.01	1.00	**0.32**	**0.12**
Loss	**-0.03**	**-0.27**	**-0.24**	**-0.41**	**0.14**	**-0.59**	**-0.15**	**0.32**	1.00	**0.13**
Class action litigation risk	**0.35**	-0.01	**0.05**	**0.14**	**-0.09**	**-0.08**	**0.02**	**0.12**	**0.13**	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 Asset-Backed Securities Reform on Management Forecast Frequency

	(1)	(2)
Treatment Effect	0.0146 (1.03)	0.0459*** (3.50)
Institutional ownership		0.6361*** (24.82)
Firm size		0.1113*** (23.29)
Book-to-market		-0.0282*** (3.78)
ROA		0.0138 (0.61)
Stock return		-0.0281** (2.46)
Earnings volatility		-0.0081 (0.41)
Loss		-0.1779*** (11.82)
Class action litigation risk		-0.1792*** (8.27)
N	16,271	16,271
R^2	0.0001	0.2439

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